The International System of States' Checks and Balances on State Sovereignty: The Case of Switzerland

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The International System of States' Checks and Balances on State Sovereignty: The Case of Switzerland

Cover Page Footnote
International Law; Commercial Law; Law
The International System of States’ Checks and Balances on State Sovereignty: The Case of Switzerland

Helga Turkut†

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  Relations, Florida International University, 2008. The author wishes to thank Drs. Félix E.
  Martín, Ben Depoorter, Katerina Linos and Andrew T. Guzman for their insightful
  comments and valuable feedback.
I. Introduction

Switzerland has claimed to be a neutral state since the beginning of the sixteenth century.1 With the adoption of the Swiss Federal Constitution in 1848, it became internationally recognized that Switzerland would steer away from foreign entanglements.2 In the last few centuries, Switzerland has successfully maintained this position. The Swiss did not enter into either World War (WWI and WWII); they are not part of the European Union (EU), and they did not become a member of the United Nations (UN) until 2002.3 Non-entanglement has defined the Swiss identity as a state and legal entity and has allowed Switzerland to prosper economically by avoiding war and creating a stable banking system.4

Despite this successful history of neutrality, Switzerland’s quest for absolute sovereignty has become increasingly difficult during the age of globalization.5 The August 19, 2009 agreement

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1 See Gordon E. Sherman, The Neutrality of Switzerland, 12 AM. J. INT’L L. 241, 241-50 (1918) (“We may, perhaps, assign a beginning to Switzerland’s neutral existence by dating it from the permanent peace between Switzerland and France concluded at Freiburg, November 12, 1516, since from this date Switzerland, considered as a homogeneous federal alliance, did not again take any direct part in warlike activities . . . “); see also infra notes 162-222 and accompanying text (discussing the history of Swiss neutrality).


between the United States and Switzerland to release the names of approximately 4450 U.S. account holders has permanently altered the Swiss privacy policy. Recently, Switzerland has been proactive in freezing the accounts of alleged human rights violators. On January 19, 2011, Switzerland froze assets of Ivorian leader, Laurent Gbagbo. On February 24, 2011, “Switzerland froze the assets of [Muammar] Qaddafi and his entourage for three years in order to avoid possible ‘misappropriation’ of these funds.” Similarly, the Swiss authorities froze assets held by former Tunisian president Zine El Abidine Beb Ali and former Egyptian President Hosni Mubarak and his immediate circle. These events marked a clear break with Switzerland’s past, when the names of account holders and their assets were strictly guarded.

This article seeks to understand why Switzerland changed its bank secrecy laws. Were the changes in Swiss banking practices the result of adaptation to the changes made within the banking environment since 2001? Or did the international system apply a form of checks and balances on Swiss sovereignty, thus

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6 See id. (discussing the components and requirements of the 2009 Agreement).


10 This article will use the term “checks and balances” to describe a system of states that use the power of treaties (legislative means), international organizations (administrative means), and courts (judicial means) to modify state behavior. In other words, as used in this article, the three elements of the classical definition of checks and balances are not creating an equilibrium between each other (as in the context of separation of powers), but are instead used in concert to create equilibrium within the international system of states.
pressuring it to amend its laws? If so, how does this form of checks and balances function in the international system of states?

To answer these questions, this article discusses three major events that led to the August 2009 agreement. First, there was intense international pressure for transparency in light of 9/11 and the 2008 financial crisis. Specifically, the market crash in October 2008 created a pressing need for the United States to tax the offshore assets of its citizens and instigate an accelerated government crack-down on tax-dodging schemes. This hunt for offshore assets was also preceded by the “Global War on Terror,” which required that intelligence agencies and banks share information on possible accounts used to fund terror cells, increase financial transparency, and monitor transactions in the wake of 9/11.

Second, Swiss banking secrecy has long been considered unethical because it has protected ruthless dictators and criminals. A growing sense of morality in the international community has created an environment where states such as Switzerland have frozen or confiscated assets held by dictators and human rights abusers.

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11 See Mark Scott, Tax Haven Crackdown Creates Opportunities for Bankers, N.Y. TIMES (Apr. 5, 2012), http://dealbook.nytimes.com/2012/04/05/crackdown-on-tax-havens-opens-opportunities-for-bankers/ (discussing the collaborative effort between countries to share information on offshore banking after the 2008 financial crisis).

12 See “Global War on Terror” is Given a New Name, WASH. POST (March 25, 2009), http://www.washingtonpost.com/wp-dyn/content/article/2009/03/24/AR2009032402818.html (discussing the Obama Administration’s distancing itself from the phrase “global war on terror,” a signature rhetorical legacy of the Bush Administration).


14 See infra notes 341-345 and accompanying text (explaining the historical relationship between dictators and Swiss banking).

15 See supra notes 7-9 and accompanying text (providing examples of recent leaders whose accounts have been frozen).
Finally, threats of criminal prosecution for tax evasion perpetrated by a major Swiss bank doing business in the United States was the ultimate step that brought about the August 2009 agreement. By examining these events in concert, this Article seeks to understand first whether the Swiss decision to curtail its bank secrecy laws was an organic response to the changing international landscape or the result of pressure applied from other states and, second, whether the international system of states can apply a form of checks and balances to states that abuse their sovereign powers.

II. The Significance of State Sovereignty

International systems exist in a state of anarchy; there is no hierarchy of legitimate authority. However, within this anarchical system are recognized rules and institutions. The contemporary international system is based on the understanding that sovereign states interact through shared interests and common values. These fundamental actors of the modern state system are “territorial units with judicial independence,” not de jure subject to external authority. Although their options can be somewhat constrained by the “power and preference of foreign actors,” states have reasonable control over their territory and the subjects within them.

With the rise of globalization and new human rights norms, however, modern state sovereignty has encountered “unprecedented pressures.” Arjun Appadurai argues that modern state sovereignty is “on its last legs” because wars, immigration,

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16 Stephen Krasner, 

17 See generally 

18 See id. at 16 (“A society of states (or international society) exists when a group of states, conscious of certain common interests and common values, form a society in the sense that they conceive themselves to be bound by a common set of rules . . . .”).

19 Krasner, supra note 16, at 229-51.

20 Id. at 230.

21 Id.

inflation, and flights of capital threaten its existence.\textsuperscript{23} According to Jessica Mathews, modern state sovereignty could be replaced with a neo-medieval system of overlapping structures of authority.\textsuperscript{24}

In contemporary terms, sovereignty has been defined in four distinct ways. First, "interdependence sovereignty" has been characterized as "the ability of states to control movement within their borders."\textsuperscript{25} Arguably, such control has diminished over time because of the Internet, cross border movements, and international capital flows.\textsuperscript{26} Thus, given the interconnectedness of issues in today's global technological age, Switzerland might pay a higher price for its unilateral policies. Second, "domestic sovereignty" refers to domestic structures of the state and their ability to function effectively.\textsuperscript{27} For this particular form of sovereignty to exist, all members of the polity must acknowledge the structures as legitimate.\textsuperscript{28} Legitimacy and effectiveness do not necessarily overlap, as in the case of failed states, but in most well-ordered domestic polities, both elements will be present.\textsuperscript{29} The third category is "Westphalian" or "Vattelian" sovereignty, which "refers to the exclusion of external sources of authority both de jure and de facto."\textsuperscript{30} Under this form of sovereignty, the state is the ultimate authoritative decision-making body at the exclusion of all other actors.\textsuperscript{31} This principle of non-intervention into the internal affairs of others was established after the Peace of

\textsuperscript{23} Id.  
\textsuperscript{24} Jessica T. Mathews, Power Shift, 76 FOREIGN AFF. 50, 61 (1997).  
\textsuperscript{25} Krasner, supra note 16, at 231.  
\textsuperscript{26} See id. (arguing that globalization and technological advances have caused a weakening of state sovereignty).  
\textsuperscript{27} Id.  
\textsuperscript{29} See Krasner, supra note 16, at 232.  
\textsuperscript{30} Id.  
\textsuperscript{31} See id.
Westphalia, which ended the Thirty Years War in 1648. This treaty “endorsed the principle of *cuius regio, eius religio* (the prince sets the religion in his territory) originally formulated in the Peace of Augsburg (1555).” The Wesphalian sovereignty thus sets forth the principle of non-interventionism in other state’s affairs. The fourth category refers to “international legal sovereignty,” which is based on mutual recognition. Under international legal sovereignty, “recognition is accorded to juridically independent territorial entities which are capable of entering into voluntary contractual agreements.” States must not be coerced into agreements; there must be diplomatic immunity, and the act of state doctrine, which prevents state actions from being challenged in foreign courts, must be respected.

Sovereignty is composed of both rules and practices, and these four categories of sovereignty are not necessarily linked. In this age of globalization and human rights norms, sovereignty is challenged because states do not have absolute control over their policies or laws. In his *Economics of Interdependence*, Richard Cooper maintains that capital mobility is undermining the ability of the state to control domestic monetary policy. Communication has “transcend[ed] the territorial concept, and the notion of each country having territorial control over electronic communications.” Issues such as pollution, the drug trade,
currency crises, and terrorism are transnational in nature and cannot be dealt within a domestic context alone.\textsuperscript{42}

Arguably, the concept of absolute sovereignty is a myth.\textsuperscript{43} Throughout history, states have acted in an interdependent environment.\textsuperscript{44} Although interdependence has varied depending on the kind of state and period in history, states have not “been able to perfectly regulate transborder flows.”\textsuperscript{45} With the establishment of the Wesphalian system, states were slow to create a sophisticated system of tax collection.\textsuperscript{46} Indeed, they relied on international borrowing to finance their activities, “the most important of which was war.”\textsuperscript{47} It was only in the nineteenth century that states developed efficient revenue collection agencies.\textsuperscript{48} Stephen Krasner argues that globalization has not necessarily undermined state activity, but rather the two have grown “hand in hand.”\textsuperscript{49} With the rise of technology and sophisticated state apparatuses, the state is able to better control some aspects of its polity, such as disease and order.\textsuperscript{50}

International norms on human rights, however, have impacted Westphalian sovereignty and states’ “right to regulate relations


\textsuperscript{42} See JAMES ROSENAU, TURBULENCE IN WORLD POLITICS: A THEORY OF CHANGE AND CONTINUITY 130 (1990); see also Krasner, supra note 16, at 234.

\textsuperscript{43} See Krasner, supra note 16, at 234 (arguing that states have always operated interdependently and will continue to do so in the face of contemporary, trans-boundary issues such as terrorism and global epidemics).

\textsuperscript{44} See id. at 234 (explaining how states have always operated in an interdependent manner).

\textsuperscript{45} Id.

\textsuperscript{46} See id. at 240-41 (attributing the eventual success of the modern European state system to an improved economic system).

\textsuperscript{47} Id. at 234.

\textsuperscript{48} See CHARLES TILLY, COERCION, CAPITAL, AND EUROPEAN STATES, AD 99-1990 53 (B. Blackwell ed., 1990) (providing a brief history of changes in “state control of capital and of coercion between AD 900 and the present”); see also Krasner, supra note 16, at 234 (noting that some European states began tax collection systems in the nineteenth century).

\textsuperscript{49} Krasner, supra note 16, at 236.

\textsuperscript{50} See generally Geoffrey Garrett, Global Market and National Politics: Collision Course of Virtuous Cycle?, 52 INT’L ORG. 787 (1998) (arguing that, as of yet, globalization has not caused a “race to the bottom”).
between [their] subjects and their rulers free of external interference." Under conventional notions of Wesphalian sovereignty, the state has ultimate control over the relations between the rulers and the polity. "Policies emanating from domestic political structures are not subject to challenge by external actors, especially external actors claiming authority in their own right." International norms and regimes establish standards that must be respected by all states. "The state might be the only actor that can establish authoritative rules within its own borders, but universal human rights norms imply that it cannot set any rule that it pleases." However, "large and powerful" states such as the United States and, until very recently, Switzerland, "have been very successful at maintaining all elements of their sovereignty." It has been more difficult for smaller and less powerful countries to succeed in the same way. Moreover, new institutions such as the EU have changed the conventional sovereignty of Europe itself. "The basic rule of international legal sovereignty, recognizing juridically independent territorial entities, no longer applies in Europe. The EU has curtailed the Wesphalian/Vatellian sovereignty of its members and altered the structure of their domestic political institutions."

III. The Law and Economics of State Sovereignty

In the past few decades, some states have passed legislation providing individuals and corporations with anonymity and protection from their home governments. By creating tax havens
for international actors, states have commercialized their sovereignty.61

Ronen Palan argues that state havens are involved in the "continuing process of state formation in a period of intensified capital mobility."62 He argues that the commercialization of state sovereignty originates from two contradicting trends.63 First, the process of shielding the state in law, which started in the sixteenth century and climaxed in the nineteenth century, has started to reverse itself.64 Second, the integration of world markets, or globalization, which began with the development of multinational corporations in the late 1800s, is on the rise.65

These two contradictory trends create a paradoxical situation where the acceleration of capital mobility and integration of world markets have been "accompanied not by any loosening of the juridical unity of the state but by, if anything, the strengthening of it."66 The friction between these two trends, that is, the "increasing insulation of the state in law and the internationalization of capital," required states to come up with creative solutions, including "the development of the tax haven and the commercialization of sovereignty."67 Palan argues that the "commercialization of state sovereignty is endemic to a system characterized by increasing economic integration within the context of political fragmentation."68 To better understand this point, this article analyzes both the rise of tax havens and states' capitalizing on national sovereignty.

A. The Rise of Tax Havens

"The complexity of modern national taxation systems, combined with greater capital mobility, has rendered practically

61 See id. at 152.
62 Id. at 153.
63 See id. (identifying the two trends as "the continuing process of insulating the state in law" and "the rowing integration of the world market").
64 Id.
65 Id.
66 Palan, Tax Havens, supra note 60, at 153.
67 Id.
68 Id. at 154.
every country in the world a potential haven from some type of taxation and regulation for residents of other countries.\textsuperscript{69} Because the potential for escaping taxes and/or regulations from the home country by using the laws of another is quite high, a clear definition of tax haven is important.\textsuperscript{70} Some analysts suggest the term "tax haven" should apply only to those states that explicitly promote themselves as such.\textsuperscript{71} Another school of thought takes a broader view, defining tax havens as "countries that have enacted tax legislation especially designed to attract the formation of branches and subsidiaries of parent companies based in heavily taxed industrial nations."\textsuperscript{72} The Organization for Economic Cooperation and Development (OECD) defines tax havens as states that have: "(1) no or nominal tax on relevant income; (2) [l]ack of effective exchange information; (3) [l]ack of transparency; [and] (4). [n]o substantial activities."\textsuperscript{73} However, most scholars and policy makers agree that tax havens develop as a result of deliberate policies in states that seek to attract international trade by minimizing taxes and reducing business regulations.\textsuperscript{74}

Tax havens share a substantial number of common traits. First, these states tend to enact strong bank secrecy laws that prohibit bank or state agents from disclosing identifying information about account holders.\textsuperscript{75} Second, tax havens have "minimal or no personal or corporation tax."\textsuperscript{76} Third, these states

\begin{itemize}
  \item \textsuperscript{69} Id.
  \item \textsuperscript{70} Id. (stating that the rise in popularity of tax havens has created some confusion about the actual definition of a "tax haven").
  \item \textsuperscript{71} See, e.g., ANTHONY S. Ginsberg, Tax Havens I (1991).
  \item \textsuperscript{72} Palan, Tax Havens, supra note 60, at 154 (quoting RICHARD ANTHONY JOHNS & C.M. Le MARCHANT, Finance Centres: British Isle Offshore Development Since 1979 (1993); ADAM STARCHILD, Tax Havens for International Business 1 (1994); Sheldon L. Banoff & Burton W. Kanter, States Compete to Save Taxes Owed to Other States, 80 J. Tax'n 382 (1994)).
  \item \textsuperscript{74} See, e.g., RICHARD ANTHONY JOHNS, Tax Havens and Offshore Finance: A Study of Transnational Economic Development 20 (1983).
  \item \textsuperscript{75} See Palan, Tax Havens, supra note 60, at 155.
  \item \textsuperscript{76} Id.
\end{itemize}
have few regulations on financial transactions and limit restrictions on business activities.\(^{77}\) Most importantly, tax havens have enacted laws that protect the secrecy of business transactions.\(^{78}\)

Palan argues that the more successful tax havens also share another set of characteristics that make them attractive to foreign companies and individuals.\(^{79}\) He maintains that “successful tax haven[]” states also “possess political and economic stability.”\(^{78}\) These successful havens “are supported by a large international financial market or are equipped with sophisticated information-exchange facilities and are within easy reach of a major financial center.”\(^{81}\) Usually, these states “have agreements with major [industrialized states] in order to avoid double taxation and regulation.”\(^{82}\) Importantly, successful tax havens “are not tainted by scandals, money laundering, or drug money.”\(^{83}\)

Palan identifies “four classes of tax havens”.\(^{84}\)
1. countries with no income tax and where foreign corporations pay only license fees (examples are Anguilla, the Bahamas, Bahrain, Bermuda, the Cayman Islands, Cook Islands, Djibouti, Turks and Caicos, and Vanuatu);
2. countries with low taxation (examples are Liechtenstein, Oman, Switzerland, Jersey, Guernsey, and the British Virgin Islands);
3. countries that levy taxes only on internal taxable events. Profits from foreign sources are either not taxed or taxed at very low rates (examples are Liberia, Panama, Philippines, Venezuela, and Hong Kong);
4. countries that grant special tax privileges to certain types of

\(^{77}\) See id.
\(^{78}\) See id.
\(^{79}\) Id. at 155-56.
\(^{80}\) Id.
\(^{81}\) Id. at 154 (citing Y. S. Park, The Economics of Offshore Financial Centers, 17 COLUM. J. WORLD BUS. 31, 33, 34 tbl.1 (1982) (describing “four different types of offshore centers”)).
companies or operations (examples are the Channel Islands, Liechtenstein, Luxembourg, the Isle of Man, Monaco, the Netherlands, the Netherlands Antilles, Austria, and Singapore).\textsuperscript{85} Other states, such as the Philippines, Jordan, Greece, and Tunisia have enacted “specific legislation for regional offices of foreign companies.”\textsuperscript{86} Regardless, however, of their classification or the extent tax havens provide incentives for foreign corporation and individuals, their combined effect on the global economy is quite significant. One study, by Global Financial Integrity, shows that “poor countries ‘lose’ more than $1 trillion a year to tax havens, around ten times the aid they receive.”\textsuperscript{87} The study claims that most of this money is not taxed because it is “illegally generated or transferred” to richer states.\textsuperscript{88} Another study by Global Financial Integrity “found that the average tax revenue loss to all developing countries was between $98 billion and $106 billion annually during the years 2002 through 2006.”\textsuperscript{89} This equates to “about 4.4 percent of the entire developing world’s government revenue.”\textsuperscript{90} Oxfam claims that “at least $6.2 trillion of developing country wealth is held offshore... depriving developing countries of annual tax receipts of between $64-124bn.”\textsuperscript{91} The Tax Justice Network says that around $11.5 trillion of private wealth is held in global offshore deposits.\textsuperscript{92} A study by ActionAid shows that companies in the FTSE 100 index had 8492

\textsuperscript{85} Id. at 154-55.
\textsuperscript{86} Id. at 155.
\textsuperscript{88} KAR & CURCIO, supra note 87, at i.
\textsuperscript{90} Id.
\textsuperscript{91} Tax Haven Crackdown Could Deliver $120bn a Year to Fight Poverty – Oxfam, OXFAM, para. 2 (Mar. 13, 2009), http://www.oxfam.org.nz/node/3378.
subsidiaries "located in tax havens." The study claims that "[o]f the 100 biggest groups listed on the London Stock Exchange, 98 use tax havens." Although these studies can only approximate to the real picture due to the difficulty of accessing this kind of information, all data show that the tax haven phenomenon is a growing concern for both the developed and developing world.

The general consensus is that "the rise of tax havens [is due] to the tremendous increase in state regulation and taxation." The heavier the regulations and taxation, the more incentives corporations and individuals have to use offshore services. The Financial Stability Forum explains:

The main contributing factor identified for the historical growth of offshore banking and [offshore financial centers] was the imposition of increased regulation (reserve requirements, interest rate ceilings, restrictions on the range of financial products, capital controls, financial disclosure requirements, high effective tax rates) in the financial sectors of industrial countries during the 1960s and 1970s. This study maintains that a number of small states began to offer a few or no regulations in order to attract business to their territory. In other words, tax havens generate income by creating a permissive regulatory environment, thus attracting foreign companies and "earning a rent from their sovereign status."
The differences between regulations and taxations in different states "can lead to perverse competition in regulatory laxity and a gravitation by some institutions to the least regulated financial centers."

Other scholars maintain "that tax havens evolve as deliberate

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94 Id.
95 See e.g., id. at 7 (discussing this particular study's limitations and difficulties).
96 Palan, Tax Havens, supra note 60, at 156.
97 See id. (explaining this relationship).
99 Trouble Island, supra note 87, at 69.
100 JOHNS, supra note 74, at 6.
state strategies [to] attract[...]. money.”

According to Palan, “[a] study commissioned by the French Parliament demonstrates convincingly that both Liechtenstein and Monaco have persistently and knowingly sought to attract hot if not criminal money.” In 2002, both Monaco and Liechtenstein were put on the OECD’s “List of Unco-operative [sic] Tax Havens.”

Tom Naylor documents how “lawyers and financiers associated with the infamous Mafia boss Meir Lansky played a key role in drafting the financial legislation of some of the best-known Caribbean tax havens.”

According to the theories of Naylor and the French Parliament, states that enact legislation to specifically attract money from doubtful sources are “abusing the [international] system of [states and their] sovereignty in order to advance [their immediate] interests.”

In contrast to these accounts, Palan suggests that while “the fledgling offshore economy was never accepted with great enthusiasm by the advanced industrialized states,” it is possible that they encouraged tax havens, albeit for a completely different set of reasons. Specifically, he argues that

the British dependencies in islands surrounding the United Kingdom and in the Caribbean and the Pacific were actively encouraged by the British state to develop their offshore economy as a way of reducing dependency on mainland. Similarly, the Dutch Antilles was developed by the Dutch state. The United States has encouraged, indirectly, the formation of

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101 Palan, Tax Havens, supra note 60, at 157.


103 See List of Unco-operative Tax Havens, OECD, para. 2, http://www.oecd.org/document/57/0,3746,en_2649_33745_30578809_1_1_1_1,00.html (last visited Jan. 13, 2013) (stating that these countries made the list for a lack of “commitments to transparency and exchange of information”). Both Liechtenstein and Monaco were removed from this list in 2009. Id. para. 3.

104 Palan, Tax Havens, supra note 60, at 157 (citing R. Thomas Naylor, HOT MONEY AND THE POLITICS OF DEBT (1st ed. 1987)).

105 Id.

the Liberian and the Marshall Islands flags of convenience.\textsuperscript{107} He further argues that it was not until the 1990s that the international community realized tax havens were becoming a problem for all industrialized states and started a “campaign against” offshore economy.\textsuperscript{108}

The first clear indication that the tax havens were no longer accepted as a legitimate way of doing business “was the publication of a 1998 OECD report titled \textit{Harmful Tax Competition: An Emerging Global Issue}.”\textsuperscript{109} The report was “[a]ccepted by all OECD members except Switzerland and Luxembourg.”\textsuperscript{110} The report criticized “harmful tax practices in the form of tax havens and harmful preferential tax regimes in OECD Member countries and non-Member countries and their dependencies.”\textsuperscript{111} A subsequent report has similarly “identified 47 preferential tax regimes in 9 categories as potentially harmful.”\textsuperscript{112}

These studies implicitly acknowledge that states have the ability to commercialize their sovereignty. Daniel W. Drezner notes that “many small countries voluntarily auction off their sovereignty to the highest bidder, reaping great rewards in the process. In some respects, it has never been so profitable to be a nation-state than in this non-nation-state world.”\textsuperscript{113} He goes on to argue that the idea of “treating sovereignty as a commodity” is nothing new.\textsuperscript{114} For example, “[i]n the 18th century, Great Britain bribed Saxony in order to buy the Saxon vote for a British electoral scheme in the Holy Roman Empire.”\textsuperscript{115} More recently,
"during the Cold War, Third World rulers were not shy about trading various aspects of their sovereignty, in the form of basing [sic] rights or UN votes, usually in exchange for superpower protection or... aid."\textsuperscript{116} Today, this commercialization has morphed into a competition between tax haven states to "enable companies to pay just the right amount of tax needed in any given situation to side-step [Controlled Foreign Companies] rules."\textsuperscript{117}

This is a disturbing race because it is "one not of diligence but of laxity."\textsuperscript{118} Robert Aliber notes that "states... use their legislative capacities as 'baits' to attract business into their jurisdictions."\textsuperscript{119} In discussing selling sovereignty services in exchange for income, Palan argues that although "[s]uch... arrangements... are perfectly legal... they are deeply disturbing."\textsuperscript{120} States and individuals or corporations "handle highly charged normative issues, such as citizenship and nationality, in purely utilitarian terms. The willful misuse of ideas and practices that go to the heart of the legitimacy of the modern state as a 'national' state is the most disturbing aspect of the tax haven phenomenon."\textsuperscript{121}

Others, such as Charles Tiebout and Gary Hufbauer, argue that "these sorts of 'arrangements'... are part of an "efficiency paradigm."\textsuperscript{122} In discussing competitive incorporation regulations in the United States, Tiebout notes that "different jurisdictions provide individuals and firms with a bundle of public services and tax regulations."\textsuperscript{123} He postulates that by people moving to "jurisdictions that offer desirable bundles of regulations," the
“municipal jurisdictions . . . are compelled to compete with each other by offering the kind of regulations that the market wants.”¹²⁴ He disagrees with “the ‘laxity races’ noted by Judge Brandeis” because he feels this kind of competition “is likely to bring about optimal public service as taxpayers adapt to the economic system” in place.¹²⁵ Hufbauer adds to this discussion by highlighting that “competition between [different jurisdictions] does not necessarily lead to a ‘race to the bottom’” but instead protects against “the states’ natural predisposition to abuse” their sovereign power.¹²⁶ Auster and Silver entertain this idea and suggest that states “are monopolistic service providers whose powers must be curbed.”¹²⁷ Further, “they implicitly welcome the commercialization of sovereignty as a means of curbing the state’s excesses.”¹²⁸

B. Commercialization of Sovereignty as a Product of Globalization

Although state sovereignty—and subsequently the society of states—evolved and strengthened with the passage of time, economic interdependence and globalization have been on the rise since the end of nineteenth century.¹²⁹ “[D]oubts . . . as to whether [the] principle of [state immunity] should be applied in cases where states were engaging in commercial activity,” according to Stephen Neff, “highlight[] the basic incompatibility, in the economic sphere, between the traditional prerogatives of sovereigns and the smooth functioning of a liberal economic system.”¹³⁰ In other words, the friction between national sovereignty and the goals of economic liberalism has led to the

¹²⁴ Id. (summarizing Tiebout, supra note 123, at 418-20).
¹²⁵ Palan, Tax Havens, supra note 60, at 158 (citing Tiebout, supra note 123, at 418-420).
¹²⁶ Id. (referring to GARY CLYDE HUFBAUER, U.S. TAXATION OF INTERNATIONAL INCOME: BLUEPRINT FOR REFORM (1992)).
¹²⁷ Id. (referring to RICHARD D. AUSTER & MORRIS SILVER, THE STATE AS A FIRM: ECONOMIC FORCES IN POLITICAL DEVELOPMENT (1979)).
¹²⁸ Id.
¹²⁹ Id. at 168 (discussing the history of this trend).
"commercialization of sovereignty."\textsuperscript{131}

States have navigated this question of "sovereignty" versus serving "the interests of capital" since the nineteenth century.\textsuperscript{132} "To resolve [this dilemma] states were forced, somewhat reluctantly, to accept the principle that legal persons could reside concomitantly in a number of jurisdictions."\textsuperscript{133} In \textit{Lauritzen v. Larsen}, the U.S. Supreme Court entertained the idea that foreign-registered ships could be liable in up to seven jurisdictions.\textsuperscript{134} The Court discussed the possibility of jurisdiction over a ship registered in Denmark, but whose seamen were involved in an incident in New York based on several theories: locality of the wrongful act, law of the flag, nationality of the injured party, nationality of the ship-owner, location where the agreement took place, inaccessibility of other forums, and "the [l]aw of the [f]orum."\textsuperscript{135}

While the idea that a corporation can reside in multiple jurisdictions "makes perfect sense from the perspective of national sovereignty, sovereign equality, and national self-determination, it has created huge problems for the regulatory capacity of the state."\textsuperscript{136} Due to the ability of legal persons to reside in multiple jurisdictions, corporations now "take advantage of the fiction of their fragmentation by rearranging their legal existence in" the most convenient and efficient manner for them.\textsuperscript{137} The fact that corporations "could ‘reside’ in one capacity in one [state] and in another capacity in another [state]," has also fueled "the practice of jurisdiction shopping" and subsequently the existence of tax havens.\textsuperscript{138} "This is the true meaning of the term ‘international tax planning’; it is the planning of whichever aspect of their ‘reality’ corporations or wealthy individuals are prepared to reveal at

\begin{itemize}
\item \textsuperscript{131} Palan, \textit{Tax Havens}, \textit{supra} note 60, at 153, 164 (using this term and referring to this relationship).
\item \textsuperscript{132} \textit{Id.} at 168.
\item \textsuperscript{133} \textit{Id.} at 172.
\item \textsuperscript{134} \textit{Lauritzen v. Larsen}, 345 U.S. 571, 582-93 (1953).
\item \textsuperscript{135} \textit{Id.} at 583-84, 586-90.
\item \textsuperscript{136} Palan, \textit{Tax Havens}, \textit{supra} note 60, at 171.
\item \textsuperscript{137} \textit{Id.} at 172.
\item \textsuperscript{138} \textit{Id.} at 170, 172.
\end{itemize}
whichever location.”\textsuperscript{139}

By “treat[ing] sovereignty as a commodity,”\textsuperscript{140} tax havens serve a double function in the modern system of states: “They demonstrate clearly [how] the modern state... accommodates globalization” and free movement of capital, while at the same time re-structure “the infrastructure of globalization.”\textsuperscript{141} Because of the fictional nature of the corporate existence in tax havens, “a virtual world of a state system can exist beside the ‘real’ state system,” while at the same time “feeding on its juridical and political infrastructure.”\textsuperscript{142} In other words, tax havens are not an anomaly in the international system; rather they are the product of globalization.\textsuperscript{143}

\textbf{IV. International Bodies Monitoring Tax Haven Activity}

Although tax havens have developed as a result of blurring firms’ national identity and globalization, the international community has not simply accepted their existence. Starting with the 1998 OECD report \textit{Harmful Tax Competition: An Emerging Global Issue}, the organization has “asked [its members] to perform a self-review of [their] preferential tax regimes.”\textsuperscript{144} In choosing to abstain from the report and its recommendations, Switzerland argued that: (1) the report did not account for all sectors of the economy and their combined effect in “distort[ing] competition,” (2) identifying one country with lower tax rates as compared to another as having a preferential tax regime “results in unacceptable protection of countries with high levels of taxation” and goes against “the economic philosophy of the OECD,” (3) “tax regimes” have different structures and “exchange of information” is not necessarily better or more efficient than tax “withholding systems,” and (4) the report is “selective and

\textsuperscript{139} \textit{Id.} at 172.

\textsuperscript{140} Drezner, \textit{supra} note 113, at 76.

\textsuperscript{141} Palan, \textit{Tax Havens, supra} note 60, at 172.

\textsuperscript{142} \textit{Id.}

\textsuperscript{143} See \textit{id.} (noting that attributes of tax havens “present the complex face of... globalization”).

\textsuperscript{144} PALAN, \textit{Offshore World, supra} note 106, at xii (referring to O.E.C.D., \textit{Harmful Tax Competition, supra} note 109, at 13).
repressive” and does not “effectively [address] excesses of tax competition that develop[] outside of all rules.”

The Financial Stability Board was created in the wake of Asian financial crisis of 1996 and 1997 to “assess vulnerabilities” and “to develop and promote the implementation of effective regulatory, supervisory and other . . . policies” in the interest of “financial stability.” The Board “brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.” In 2000, the Board published the Report of the Working Group on Offshore Centers, which listed financial abuses in tax havens and highlighted a few recommendations for cooperation and transparency.

Similarly the Financial Action Task Force (on Money Laundering), established in 1989 on the G7 initiative, has created a powerful name and shame list. In 2000, the organization issued a list of “Non-Cooperative Countries and Territories,” and has revised that list since that time. While the organization does not have to power to impose sanctions or pursue any legal remedies,
the existence of the list and the association with countries that protect terrorists or criminals creates immense international pressure on tax havens.

The EU has also proactively combated tax havens by introducing two important directives: the Savings Taxation Directive, which serves to crack down on tax evasion, and the Code of Conduct for Business Taxation. The Savings Taxation Directive came into force in 2005 and targets individuals. EU member states have agreed "to automatically exchange information about customers who earn savings income in one EU member state but reside in another." This directive also temporarily allowed some member states to utilize a "withholding tax option," which permits deduction of tax from savings income at the source of the income. The Code of Conduct for Business Taxation was established in 1998, and while "not a legally binding instrument, ... it clearly ... ha[s] political force." It prohibits member states "from introducing any new harmful tax measures," and, further, from amending "any laws or practices that are deemed to be harmful in respect of the principles of the Code."

Although this is not a comprehensive list of all international bodies that have worked to curb the harmful effect of tax havens, these examples show that the international community has been proactive in fighting tax havens both for security and economic reasons. As will be elaborated at length later in this article the international community has entered into bilateral, multilateral agreements with tax haven states to curtail lost tax revenue. The United States has even gone further by bringing tax haven banks

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155 PALAN, OFFSHORE WORLD, supra note 106, at xiii.

156 Id.


158 Id. para. 4.
into its court to demand transparency and cooperation.\textsuperscript{159} Furthermore, both the OECD and the G20\textsuperscript{160} have created a "blacklist" for tax havens for the purpose of "naming and shaming" states that do not comply with an "internationally agreed tax standard."\textsuperscript{161} This article uses the case of Switzerland to illustrate how international agreements, international institutions, and domestic courts are tools that the international community has used to restrict the use of state sovereignty for tax evasion purposes.

V. Switzerland As a Case Study of Checks and Balances of the International System of States on Sovereignty

Switzerland is an excellent case study to examine whether the international system has the capacity to exercise a form of checks and balances on state sovereignty because the country is, in many ways, defined by its independence and neutrality from the system of states. Gordon Sherman notes that "Swiss neutrality is an [historical and] essential element of the country’s governmental existence, and it is intended by the nature and sanction of its origins to be as permanent as the nation itself."\textsuperscript{162} This aspect of Swiss identity was the result of "a historical, geographical, political, military, and economic necessity."\textsuperscript{163} Indeed, neutrality is so important to the Swiss that "only after an intense domestic debate and a national referendum did the country join the UN on September 10, 2002."\textsuperscript{164}

\textsuperscript{159} See Swiss Bank Refuses US Tax Request, BBC NEWS (May 1, 2009), http://news.bbc.co.uk/2/hi/business/8028174.stm (discussing such a situation).
\textsuperscript{160} The G20 is a group of countries who "coordinate both economic and foreign affairs policies using periodic meetings of high level officials." Sungjoon Che & Claire R. Kelly, Promises and Perils of New Global Governance: A Case of the G20, 12 Chi. J. Int'l L. 491, 516 (2012)
\textsuperscript{161} Nicholas Watt et al., G20 Declares Door Shut on Tax Havens: OECD Publishing List of Member Countries That Do Not Comply with Its Rules, GUARDIAN (Apr. 2, 2009), http://www.guardian.co.uk/world/2009/apr/02/g20-summit-tax-havens.
\textsuperscript{163} HELGA TURKU, ISOLATIONIST STATES IN AN INTERDEPENDENT WORLD 51-52 (2009) (discussing international treaties and agreements that gave rise to the Swiss "perpetual neutrality").
\textsuperscript{164} Id.
A. The Origins of Swiss Banking Secrecy Law

There are two major schools of thought that attempt to explain the origin of Swiss banking secrecy laws. Sébastien Guex has detailed these schools and provided further context as to the origins of Swiss secrecy laws.\textsuperscript{165} As Guex explains, the more widely adopted theory of Swiss banking secrecy laws stipulates that Swiss banking secrecy arose out of a desire to protect the Jewish victims of Nazi persecution.\textsuperscript{166} Since the 1960s, many have maintained that the secrecy laws were introduced in 1934 as part of the Federal Banking Law.\textsuperscript{167} Philippe de Weck, former president of the Union Bank of Switzerland, believes that the Banking Secrecy Law was introduced into Swiss legislation because of "this influx of capital belonging to the victims of persecution."\textsuperscript{168} Emissaries of Nazi organizations actually followed the immigrants to Switzerland. They endeavored to obtain information concerning the capital they held in Switzerland. Once in possession of such information, they would have been in a position to blackmail members of their families still in Germany. It was in order to prevent such information from coming into the possession of Nazi emissaries that a particularly stringent Banking Secrecy Law was introduced into Swiss legislation at the time.\textsuperscript{169}

De Weck maintains that this was a courageous act at the time because Germany shared a border with Switzerland and could have taken action.\textsuperscript{170} He has further stated that the banking secrecy laws were almost a form of "humanitarian action."\textsuperscript{171} Indeed, "many Swiss are proud of their banking-secrecy law, because it... has admirable origins (it was passed in the 1930s to

\begin{footnotes}
\item[166] Id. at 240 (arguing that this common view is incorrect).
\item[167] Id. at 239.
\item[168] This opinion is according to translations provided by Guex. Id.
\item[169] Id.
\item[170] Id.
\item[171] Guex, supra note 165, at 239.
\end{footnotes}
help persecuted Jews protect their savings.)" Even scholars critical of these laws admit that [b]anking "[s]ecrecy laws . . . were introduced in 1934—in part to protect Jews who were depositing money in Swiss Banks." The second school of thought maintains that the notion that Switzerland wanted to protect Jewish victims is not supported by facts. Guex argues that these laws were not introduced in 1934, but were "merely reinforced at that time." More importantly, he claims that there are no facts to support the claim that these laws were introduced for "humanitarian reasons." Furthermore, the way that the Swiss bankers have handled the accounts of victims of the Holocaust calls into question the idea that Swiss banking laws were designed with a humanitarian motivation in mind. As will be further discussed in this article, descendants of Holocaust victims are still trying to access some of their assets from Swiss banks, which serviced both the Nazis and the Jewish community.

Before 1934, the Swiss Banking Laws were based more on practice than a concrete body of law. Several laws dealing only with public banks existed in a few Swiss cantons. At one time,

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172 Id. (quoting Keeping Mum, ECONOMIST, Feb. 17, 1996, at 78).
174 Guex, supra note 165, at 240.
175 Id.
176 See id. at 240 (stating that the Swiss Banking Secrecy Law has been "severely questioned" recently because of "the way bankers have handled the accounts of victims of the Nazis"); see also SWISS FEDERAL ARCHIVES, FLIGHT FUNDS, LOOTED PROPERTY AND DORMANT ASSETS: STATUS OF RESEARCH AND ITS PERSPECTIVES 52 (1997) (discussing unclaimed dormant assets remaining from World War II); see generally INDEP. COMM. OF EMINENT PERSONS, REPORT ON DORMANT ACCOUNTS OF VICTIMS OF NAZI PERSECUTION IN SWISS BANKS (1999) (reporting on the investigation of Nazi victims' Swiss bank accounts).
177 For additional discussion about the efforts of Holocaust victims to access their assets held in Swiss banks, see infra text accompanying note 359.
178 See Guex, supra note 165, at 240 ("At the time, this practice was based on tradition rather than on a concrete law or set of laws.").
179 See id. (noting that the banking secrecy laws existing at the time were adopted in only a few Swiss cantons). Switzerland is made up of twenty-two cantons, which are similar to U.S. states. Id.
banking secrecy was a civil matter and not a criminal one. Consequently, the damaged party could only sue for damages in a civil court. The lack of rigorous laws in this area did not prevent the widespread practice of banking secrecy, making it difficult for the authorities to "pursue fiscal objectives." Even though banking secrecy practices were well established in Switzerland, its importance grew at the turn of the twentieth century when several European states imposed increased taxation on their wealthy citizens.

Located in a landlocked country with aggressive neighbors and no "comparable industrial or commercial power," Swiss banks could not compete with other financial centers such as London, Paris, or Berlin. This being the case, however, the Swiss recognized an opportunity to react to a wave of tax increases spreading across Europe. Given these circumstances, the Swiss realized that their banks could offer customers an advantage that others did not: the evasion of domestic taxation. This tax evasion became the Swiss strategy for attracting foreign capital and becoming competitive in international finance even before WWI. Swiss banks advertised throughout Europe promoting the advantages of their country as a tax haven. In an advertisement distributed in France, a Swiss bank claimed that the laws in

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180 Id.
181 See id. (explaining that "sanctions could be imposed only if a claim had been lodged by the injured party, and in the form of damages").
182 Id.
183 Guex, supra note 165, at 240-41. In 1901, for example, France increased its inheritance tax and laid the groundwork for the introduction of an income tax on high revenues. Id. at 241.
184 Id.
185 See id. (describing the opportunity seized by the Swiss banking industry to compete as a tax haven on the international stage).
186 Id.
187 See id. ("For those in Swiss business circles, banking secrecy was no longer simply an instrument with primarily internal functions that was designed to protect them from the domestic tax authorities. It now also became an instrument with external functions, a lynchpin in the strategy of attracting foreign capital to Switzerland and hence a major asset in international competition.").
188 See Guex, supra note 165, at 241 (describing the campaign to promote Swiss banking as "massive").
Switzerland "enable[] [us] to manage with the utmost discretion securities entrusted to our care by costumers abroad." These messages were so intense that the Swiss authorities feared retaliation from foreign governments. The Swiss minister of economy intervened by asking the banks to ease their claims.

At the start of WWI, immense financial uncertainties and high taxation allowed Swiss banks to flourish. Foreign capital from France, Germany, Italy, and Austria "poured into Swiss banks" at an unprecedented rate. Swiss bank depositors were attracted to Switzerland's neutrality, political stability, and mild taxation laws; the stability of the Swiss franc; and, notably, Switzerland's banking secrecy practices. Within a very short time, Swiss banks enjoyed tremendous growth, but it is difficult to establish how much of this success can be contributed to foreign capital from secrecy laws. "Switzerland became transformed into an international financial center," whose status was further aided by the establishment of the Bank for International Settlements. Switzerland also became a "refuge of choice for foreign capital," able to both attract foreign capital and reinvest it abroad under its own name.

Foreign governments, however, did not turn a blind eye to the

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189 Id.
190 Id. (noting that the propaganda campaign was "intense" even before WWI and that Swiss officials were "fearful" of retaliation from other governments).
191 See id. (citing DOCUMENTS DIPLOMATIQUES SUISSES 901 (V. 5 1983) for comparison).
192 Id. at 241-42 (explaining how the "political, financial, and monetary crises" in Europe prior to WWI and the increase in domestic taxes in other countries led to increased investment in Swiss banks).
193 Id. at 241.
194 Guex, supra note 165, at 241-42.
195 See id. at 242 (describing the "spectacular takeoff" enjoyed by Swiss banks at the time).
196 Id. (quoting HUGO BANZIGER, DIE ENTWICKLUNG DER BANKENAUFSICHT IN DER SCHWEIZ SEIT DEM 19. JAHRHUNDERT 57 (1986)).
197 Id. at 242.
198 See id. (noting that Switzerland became "a place for the reception of assets coming from abroad, assets that were in turn lent abroad again, but this time under the Swiss flag").
massive exodus of international capital to Switzerland.\textsuperscript{199} States such as France and Belgium were very concerned by wealthy citizens evading taxation by using Swiss bank accounts.\textsuperscript{200} In addition, France and Belgium feared that the large amount of German capital in Switzerland following WWI could endanger the reparation payments imposed on Germany by the Treaty of Versailles.\textsuperscript{201} France and Belgium attempted to gather information about the identity of Swiss bank customers.\textsuperscript{202}

At the end of WWI, these countries made "modest" efforts to try to obtain information on individuals and entities that had accounts in Switzerland.\textsuperscript{203} However, Swiss authorities refused to make any concessions, with the full knowledge that "in several countries... there will be deep resentment against Switzerland because of this attitude."\textsuperscript{204} The Swiss knew that disclosing information on foreign asset holders in Switzerland would jeopardize its banking system.\textsuperscript{205} "The importance of banking activity to the Swiss economy calls for the greatest prudence as far as measures against tax evasion are concerned. This is why the Committee of the Swiss Bankers' Association has likewise decided strictly to reject... any measure combating this evasion."\textsuperscript{206}

Then, in the second half of 1931, Switzerland went through the "worst banking crisis in its history."\textsuperscript{207} As a result of internal pressure to stabilize the banking industry, the Federal Council formulated a banking law in January 1933, drafting, among other

\textsuperscript{199} See id. (describing the efforts of foreign countries to stop the "massive exodus of international capital to the Swiss haven").

\textsuperscript{200} Guex, supra note 165, at 242.

\textsuperscript{201} Id.

\textsuperscript{202} See id. (explaining France's and Belgium's actions as a direct result of the flight of significant capital from these countries to Swiss banks).

\textsuperscript{203} Id. at 242-43 (quoting the Minutes of the Federal Council's meeting of Mar. 21, 1924, E 1004.1 (held in Swiss Federal Archives, 1924)).

\textsuperscript{204} Id. at 243 (describing Switzerland's efforts to protect banking secrecy as calling for the "greatest prudence as far as measures against tax evasion are concerned").

\textsuperscript{205} Id. at 243 (describing Switzerland's efforts to protect banking secrecy as calling for the "greatest prudence as far as measures against tax evasion are concerned").

\textsuperscript{206} Guex, supra note 165, at 243 (quoting the Minutes of the Federal Council's meeting of Mar. 21, 1924, E 1004.1 (held in Swiss Federal Archives, 1924)).

\textsuperscript{207} Id. at 243.
things, an article on banking secrecy. This draft provision passed without further substantive modification in November 1934 as article 47 of the Banking Law. Violation of the banking secrecy provision under article 47 was considered a criminal offense punishable with “heavy fines and up to six months’ imprisonment.”

Swiss banking secrecy is protected through banking laws, criminal laws, civil laws, and codes of professional obligation. The Swiss Banking Act of 1934 codified the protection of bank secrecy in Switzerland. These laws require that Swiss banks preserve the privacy of their clients. Punishment for disclosing such information includes criminal and civil liability. Moreover, anyone who “intentionally violates the duty of privacy faces severe criminal sanctions, including imprisonment.”

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208 Id. at 244.
209 See id. ("[T]he future article 47 of the Banking Law voted by the Swiss Parliament in November 1934 remained practically identical, in substance if not in form, to the corresponding article of the February 1933 draft.").
210 Guex, supra note 165, at 244.
212 See Guex, supra note 165, at 244 (noting that the codification of the 1934 law reinforced the importance of banking secrecy in Switzerland and provided a “clear basis” for the practice in federal law).
213 See Peter C. Honegger, Jr., Demystification of the Swiss Banking Secrecy and Illumination of the United States-Swiss Memorandum of Understanding, 9 N.C. J. INT’L L. & COM. REG. 1, 1-2 (1983) (“[B]anks must keep secret any information about their clients regarding privacy and property, which they receive by practicing their business.”).
214 Guex, supra note 165, at 244.

Article 47 states: “Any person who willfully ... (b) in his capacity as organ, officer or employee of a bank, as auditor or assistant auditor, as member of the Banking Commission, officer or employee of its secretarial office, violates his duty to observe silence or the professional secrecy, or whoever induces or
Switzerland's laws are especially strict regarding acts of espionage under the premise that such disclosure may harm the Swiss economy.\textsuperscript{216} Articles 27 and 28 of the Swiss Civil Code protect privacy rights of the individual and legal entities.\textsuperscript{217} Contract law, agency law, and the good faith principles set forth in the Swiss Civil Code create an implied duty of discretion for bankers.\textsuperscript{218}

There are a few exceptions to Swiss secrecy laws. Specifically, a client may instruct his Swiss bank to disclose his information to a third party.\textsuperscript{219} In limited circumstances, Swiss banks may divulge bank secrets to Swiss authorities, but not to foreign entities.\textsuperscript{220} Until recently, the only way foreign authorities

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\item \textsuperscript{216} \textit{Swiss Criminal Code, supra} note 215, art. 273. Article 273 states that anyone who makes accessible a manufacturing or business secret to a foreign official, agency, or foreign organization, private enterprise, or to any agents of the same, can be punished by imprisonment or fine (or both). \textit{Id}; see also Moser, \textit{supra} note 211, at 324 ("Under Article 273, dealing with 'espionage and the supplying of economic information to foreign officials and private organizations,' the Swiss Penal Code imposes the duty of banking secrecy on the financier under the theory that a disclosure of domestic information might harm Switzerland economically.").
\item \textsuperscript{217} \textit{See Honegger, supra} note 213, at 2 (noting that these articles provide protection of "personality rights," including the rights of "natural and legal persons (i.e. corporate bodies)").
\item \textsuperscript{218} \textit{See id.} ("[D]iscretion is an implied contractual duty of the banker[;]... the banker has a general duty of discretion based on the mentioned good faith principle of the Swiss Civil Code.").
\item \textsuperscript{219} \textit{See Alfadda v. Fenn, 149 F.R.D. 28, 32 (S.D.N.Y. 1993) ("[S]ecrecy required... may be waived by the consent of the person.").
\item \textsuperscript{220} Honegger, \textit{supra} note 213, at 8. It is important to note, however, that Swiss bank secrecy laws are not designed to provide a competitive advantage to Swiss banks; the bank privacy laws of Switzerland apply to all information located within Switzerland, without regard to the nationality of the bank, account holder, or requesting entity. \textit{See Minpeco v. Conticommodity Servs., Inc., 116 F.R.D. 517, 524 (S.D.N.Y. 1987) ("[T]he bank secrecy laws... have the legitimate purpose of protecting commercial privacy inside and outside Switzerland.").
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could access privileged information was through Swiss diplomatic channels. A number of treaties, which will be discussed later in this article, allow the Swiss government to assist foreign authorities by allowing Swiss banks to disclose client secrets.

**B. Events that Contributed to the Changes in Swiss Banking Laws**

In order to understand whether there is a form of checks and balances in the international system of states, one needs to examine whether the changes in Swiss banking laws were guided by domestic interests or were the result of external pressure. If they were the result of external pressure, what steps did the international community take to curtail Switzerland’s hold on bank secrecy?

1. **International Pressure for Banking Transparency**

   **i. The 2008 Financial Meltdown**

   In 2009, UBS, a major Swiss financial institution, was forced to pay over $700 million in fines and disclose thousands of names of U.S. customers hiding assets at UBS avoid taxation in the United States. One of the most important causes of the UBS exposure was the pressure from all US states impacted by the meltdown of the US financial markets in 2008. According to the US Senate Committee on Investigations, the United States loses roughly $100 billion in tax revenue annually from foreign investment. Specifically, the Committee believes that about

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221 See Honegger, supra note 213, at 8 (“Foreign authorities have to request judicial assistance by their diplomatic missions unless there is a special agreement.”).


224 Id.

225 See STAFF OF S. COMM. ON THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, 110TH CONG., REP. ON TAX HAVEN BANKS AND U.S. TAX COMPLIANCE 1 (Comm. Print 2008) (noting that the U.S. loses $100 billion loss in tax revenues each year to offshore tax abuses).
$14.8 billion worth of American assets are hidden in secret Swiss accounts.\textsuperscript{226} In early 2009, OECD listed Switzerland on its "grey list" and threatened to impose financial sanctions on Switzerland for not cooperating in tax evasion cases with other states.\textsuperscript{227} The United States increased pressure on Switzerland to modify their approach to bank secrecy.\textsuperscript{228}

The United States determines that a state is a tax haven in two different ways: an objective approach and a subjective approach. The objective approach defines a tax haven state as "any nation which has no tax or a low rate of tax on all or certain categories of income and which offers a certain level of banking or commercial secrecy."\textsuperscript{229} The subjective approach defines a state as a tax haven if "it promotes itself as one, and those who specialize in international tax planning consider it to be one."\textsuperscript{230} Accordingly, before the UBS agreement, Switzerland was a tax haven under both approaches because it enabled American citizens to invest without paying taxes, had strict banking confidentiality, and its banks actively marketed their private banking services to US clients to avoid paying taxes.\textsuperscript{231}

Strict privacy laws and banking expertise make Switzerland an attractive tax haven for wealthy Americans. In 2008, the Senate Committee on Investigations found that UBS alone "maintain[ed] . . . an estimated 19,000 US clients 'undeclared' accounts in


\textsuperscript{228} See L. Gordon Crovitz, \textit{Swiss Banks and the End of Privacy}, \textit{WALL ST. J.}, Mar. 23, 2009, at A13 (discussing the efforts of the U.S. and other nations to influence Switzerland to modify the country’s privacy laws to allow for increased disclosure, particularly in cases of tax evasion).


\textsuperscript{230} Id.

\textsuperscript{231} See generally \textit{Deferred Prosecution Agreement}, U.S. v. UBS AG, No. 09-60033, ¶ 9 (S.D.FLA. Feb. 18, 2009) [hereinafter Deferred Prosecution Agreement] (discussing the ways UBS defrauded the IRS and was enabled under Swiss law).
Switzerland with billions of dollars in assets that have not been disclosed to US tax authorities.”

In light of the ease with which US citizens were able to hide their assets and avoid paying taxes and the 2008 financial crisis, the United States announced a plan to reform corporate taxation. In May 2009, the White House declared that it would strictly enforce laws against tax haven abuse in an effort to raise $8.7 billion in tax revenues. US President Barack Obama stated that “[i]f financial institutions won’t cooperate with us, we will assume that they are sheltering money in tax havens, and act accordingly.”

President Obama was not the only world leader to take such a stern stand against tax evasion in light of what has become known as the “Great Recession.” In September 2008, British Prime Minister Gordon Brown called for a new global financial system to bring an end to financial turmoil. Specifically, he called on all UN members to “build a new global financial order founded on transparency, not opacity; rewarding success, not excess; responsibility, not impunity; and which is global, not national.” He stated that cooperation, not isolationism and protectionism, is the solution to “living in a global age.”

232 STAFF OF S. COMM. ON THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, supra note 225, at 8.
233 See Carolyn B. Lovejoy, UBS Strikes a Deal: The Recent Impact of Weakened Bank Secrecy on Swiss Banking, 14 N.C. BANKING INST. 435, 437 (2010) (describing the Obama Administration’s plan to strictly enforce laws against tax haven abuse in an effort to raise significant tax revenues).
234 Id.
236 See generally Courtney Schlisserman, ‘Great Recession’ Gets Recognition as Entry in AP Stylebook, BLOOMBERG (Feb. 23, 2010), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ayojB2KWQG4k (stating that the phrase the “Great Recession” is now officially used for the economic downturn beginning in December 2007).
238 Id.
239 Id.
crisis, a place like Switzerland, home to nearly a third of all wealth stashed in tax havens (nearly $2.2 trillion), became an easy target for governments seeking revenue to finance their own economic stimulus programs.240

The international community has fought bank secrecy laws since long before the Great Recession because of significant economic losses in tax evasions.241 Tax havens are located in some of the largest financial centers on the globe.242 Although these states account only for three percent of the world’s gross domestic product (GDP), “half of the world trade appears to pass through tax havens.”243 Specifically, at least $11 trillion are held in offshore banks where capital is subject to little or no taxation.244 Swiss banks manage one-third of all cross-border private banking.245 While the Swiss do not generally tax income earned on capital invested in foreign locations at the home country’s rate, the country does impose a withholding tax.246 Interest earned on

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240 See Emma Thomasson, US Civil Case No Big Threat to UBS-Swiss Regulator, REUTERS (Feb. 21, 2009), http://uk.reuters.com/article/2009/02/21/ubs-idUKLL61373220090221 (“Tax-dodging schemes are increasingly under attack by governments scrambling to find revenue needed to finance the soaring costs of government stimulus programmes.”).


242 See generally Gurtner, supra note 241 (discussing the ways tax haven states function and benefit companies and wealthy individuals, among others).

243 Id. at 24.

244 Id.

245 Id.

246 Brabec, supra note 241, at 253; see also Cynthia Blum, Sharing Bank Deposit Information with Other Countries: Should Tax Compliance or Privacy Claims Prevail?, 6 FLA. TAX REV. 579, 601 (2004) (describing the Savings Directive adopted by EU countries, which provides for “automatic [tax] information exchange on interest paid within the EU to a EU resident” and allows certain EU countries, excluding Switzerland, to impose a withholding tax).
capital investments is generally underreported or not reported at all.\textsuperscript{247}

Among other countries, the United States, Japan, and the EU have threatened to limit investments if Switzerland does not address its taxation loopholes and bank secrecy laws.\textsuperscript{248} In 2009, Switzerland was added to the OECD’s list of “[j]urisdictions that have committed to the internationally agreed tax standard, but have not yet substantially implemented” it due to its lack of cooperation.\textsuperscript{249} To get off this list, Switzerland would eventually enter into twelve bilateral tax cooperation agreements with the OECD.\textsuperscript{250} Moreover, Switzerland would have to effectively implement those agreements, instead of using its definition of tax fraud and the application of double incrimination as a shield to restrict information exchange in cases that constitute criminal tax cases in the OECD countries.\textsuperscript{251}

The change was a contentious point between the OECD and Switzerland because Switzerland expressly placed a restriction on

\textsuperscript{247} Brabec, supra note 241, at 253.

\textsuperscript{248} See id. (noting that these countries have threatened “investment curbs” if the Swiss government does not adequately address “taxation loopholes”).


\textsuperscript{250} See generally Miseror, Double Tax Treaties and Tax Information Exchange Agreements: What Advantages for Developing Countries?, TAX JUST. NETWORK, http://www.taxjustice.net/cms/upload/pdf/DTTs_100126_TIEAs-Developing-Countries.pdf (last visited Jan. 14, 2013) (describing the OECD Model Tax Convention on Income and Capital, Double Tax Treaties (DTTs), and Tax Information Exchange Agreements (TIEAs) as the primary tools for meeting international goals for tax transparency and noting that any jurisdiction that signs twelve or more of these agreements “is considered cooperative” and removed from OECD’s list of “non-committing or non-implementing countries”).

\textsuperscript{251} See Brabec, supra note 241, at 251 (“[T]he principal [of ‘double incrimination’] means that to receive information on a person’s bank account, the crime must be a crime in both the home country and the host country.” (emphasis added)).
Article 26(1) of the OECD Model Tax Convention to protect its secrecy laws. Article 26(1) requires that “[t]he competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention . . . insofar as the taxation [t]hereunder is not contrary to the Convention.” Specifically, to meet this article’s requirements, Switzerland would have to provide administrative assistance to states that seek “justified and specific” information about the requesting country’s citizens. The request must specify the foreign taxpayer’s personal data and the Swiss entity that can provide that information. Until March 13, 2009, when the Swiss Federal Council announced that Switzerland would offer administrative assistance in individual cases where there is well-founded suspicion of tax fraud, the Swiss showed reservation about Article 26, indicating that it provides for the dissemination of information relevant only to the contracting states’ domestic tax laws.

After the UBS controversy, Switzerland changed its position on the issue and entered into twelve bilateral taxation agreements

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252 See Peter R. Altenburger, Presentation: Exchange of Information: Switzerland’s Position Evolves Over Time (May 25, 2000), http://www.altenburger.ch/uploads/tx_altenburger/pa_2000_Seminar_on_Swiss_Taxation.pdf (“Switzerland has issued a reservation on Art. 26 of the OECD Model Convention. It will propose to limit the scope of this Article to information which is necessary to carry out the provisions of the Convention.”).


255 Id.


257 See Altenburger, supra note 252, at 2 (“Switzerland’s negative attitude on providing information which may only be relevant with respect to the other Contracting States’ domestic tax laws, has led to a distinction between administrative assistance and legal assistance.”).
as required by the OECD. Additionally, Switzerland adopted the OECD standard on administrative assistance in fiscal matters. This assistance, however, is only administrative and not legal. Switzerland may grant legal assistance if there are sufficient facts to lead to the conclusion that a crime may have been committed.

The March 13, 2009 announcement blurred the distinction between tax fraud and tax evasion. Until this time, using fraudulent practices or producing false documents constituted tax fraud and was a criminal matter, while tax evasion, defined as "the non-reporting or the incomplete reporting of income or assets without any further manipulations," was a civil matter. Thus, "banks had no duty to provide information to tax authorities."

258 See Switzerland Removed from OECD “Grey List, supra note 227 (stating that Switzerland signed twelve agreements to provide “administrative assistance in tax matters”).


261 Altenburger, supra note 252, at 3 ("In order for Switzerland to grant legal assistance it is not necessary that the facts are being proven, it is enough if the facts are leading to the conclusion that a crime may have been committed.").

262 See id. at 2 (stating the difference between tax avoidance, fraud, and evasion).

263 See Honegger, supra note 213, at 7 (showing some cantons treat tax fraud as a crime, including the cantons where the major banking centers of Switzerland are located); see generally Trade Dev. Bank v. Continental Ins. Co., 469 F.2d 35, 40 (2d Cir. 1972) (finding that although an individual Swiss canton may have its own procedural rules that could override the Swiss Federal Banking Act in a proceeding pending in that canton, a canton procedural rule would not apply to a proceeding in the United States).

264 Bondi, supra note 215, at 18; Honegger, supra note 213, at 7.

265 See Honegger, supra note 213, at 7 (stating that Cantonal tax laws do not provide for a duty to distribute information to tax authorities); see also Bernhard F. Meyer, Swiss Banking Secrecy and Its Legal Implications in the United States, 14 NEW. ENG. L. REV. 18, 32 (1979) ("[I]n administrative trial court proceedings, rules of civil procedure may be applicable since governing administrative laws often refer to the civil code with regard to the proper court procedure.").
On the other hand, in the United States, tax evasion is a criminal violation.\textsuperscript{266} Due to this distinction in Swiss law, the banks would only transfer information to U.S. authorities "where the equivalent of criminal tax fraud had occurred under Swiss law, not mere tax evasion."\textsuperscript{267}

Since the March 13, 2009 decision, however, Swiss authorities have allowed the exchange of information with other states in individual cases where a justified and specific request has been made.\textsuperscript{268} By providing administrative assistance in prosecuting tax evaders, Switzerland is now in compliance with Article 26 of the OECD Model Tax Convention.\textsuperscript{269} According to the Swiss Federal Council, the decision to provide administrative assistance to a foreign government does not mean that there will be "any form of automatic exchange of information."\textsuperscript{270}

\textit{ii. Switzerland Tax Treaties}

Two of the earliest agreements regarding information exchange between Switzerland and the United States are the Treaty on Mutual Assistance in Criminal Matters in 1975 (TMACM) and the Convention for the Avoidance of Double Taxation with Respect to Taxes on Income in 1951 (the Convention).\textsuperscript{271} "The TMACM provides that Swiss authorities must make certain identifying information available to the US that would assist in investigating and prosecuting [offenses] listed in


\textsuperscript{267} Bondi, supra note 215, at 6.

\textsuperscript{268} See id.


the treaty," such as murder, rape, and fraud.\textsuperscript{272} The following are conditions for providing identifying information that was previously held secret:

(a) the request concerns the investigation or prosecution of a serious offense, (b) the disclosure is of importance for obtaining or proving facts which are of substantial significance for the investigation or proceeding; and (c) reasonable but unsuccessful efforts have been made in the United States to obtain the evidence or information in other ways.\textsuperscript{273}

However, the power of TMACM is limited, as Switzerland can refuse to assist the United States if it "considers that the execution of the request is likely to prejudice its sovereignty, security or similar essential interests."\textsuperscript{274} "This 'general safeguarding clause' ensures that Switzerland could 'plead important interests' in order to refuse a request of the US."\textsuperscript{275} Moreover, since establishing its banking secrecy laws, Switzerland has "been diligent in rejecting generalized requests for information concerning large groups of people, or 'fishing expeditions.'"\textsuperscript{276} The TMACM does not list tax evasion as one of the offenses that would mandate providing information.\textsuperscript{277} "Therefore, Switzerland can limit the effect of TMCAM on tax evasion investigations because it can claim protection against prejudice to sovereignty and national interests."\textsuperscript{278}

In 1982, Switzerland and the United States signed the Memorandum of Understanding (Swiss MOU) after increased

\textsuperscript{272} Carolyn B. Lovejoy, \textit{UBS Strokes a Deal: The Recent Impact of Weaked Bank Secrecy on Swiss Banking}, 14 N.C. BANKING INST. 435, 444-45 (2010) (citing Treaty on Mutual Assistance in Criminal Matters, \textit{supra} note 271, art. 23 (stating that the Swiss Central Authority will handle requests for assistance)).

\textsuperscript{273} Treaty on Mutual Assistance in Criminal Matters, \textit{supra} note 271, art. 10.

\textsuperscript{274} \textit{Id}. art. 3.

\textsuperscript{275} Lovejoy, \textit{supra} note 272, at 445 (quoting Urs Martin Lauchli, \textit{Swiss Bank Secrecy with Comparative Aspects to the American Approach}, 42 ST. LOUIS U. L.J. 865, 875 (1998)).

\textsuperscript{276} Lauchli, \textit{supra} note 275, at 876.

\textsuperscript{277} See generally Treaty on Mutual Assistance in Criminal Matters, \textit{supra} note 271 (showing tax evasion is not a listed offense).

\textsuperscript{278} Lovejoy, \textit{supra} note 272, at 445.
pressure from the latter. "The Swiss MOU was specifically designed to deal with insider trading inefficiencies of the Swiss MLAT." Through this MOU, Switzerland would cooperate in insider trading investigations by establishing mechanisms to collect the needed information. In 1981, Switzerland also enacted the law on International Mutual Assistance in Criminal Matters (IMAC), which allowed Swiss authorities to provide legal assistance to other states for offenses that were considered a crime in Switzerland.

The 1951 Convention for the Avoidance Double Taxation between Switzerland and the United States also "ensures an effective information exchange to prevent fraud and to avoid both nations 'claiming the right to tax the same stream of income.'" To fulfill their obligations under the Convention, Switzerland and the United States maintain direct information exchange with each other. Through this Convention, the authorities are able to "prescribe procedures to carry out the purposes of this Convention." However, the Convention did not address tax evasion until the parties entered into a protocol to the Convention on September 23, 2009, which "expand[ed] this cooperation to tax evasion as well as tax fraud . . ." According to the Protocol, "Switzerland cannot refuse to give information to the US because the 'information is held by a bank.'" If such a case arises, Swiss

280 Najera, supra note 260, at 116.
282 Najera, supra note 260, at 117 (citing Lauchli, supra note 275, at 873).
283 Lovejoy, supra note 272, at 445 (quoting Workman, supra note 229, at 687).
284 See Convention for the Avoidance of Double Taxation with Respect to Taxes on Income, supra note 271.
285 Id. art. 29.
286 Daniel Pruzin, Swiss Court Orders UBS to Notify Clients Before Turning Account Details Over to U.S., BNA BANKING DAILY (Sept. 25, 2009).
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authorities 'have the power to enforce disclosure of information.'

The 2009 Protocol built upon other agreements between the two states. In 1996, the United States and Switzerland signed the Tax Information Exchange Act (1996 Agreement), which aimed to share information and "specifically addressed fraudulent conduct." However, as seen with previous attempts, this treaty did not yield the results the United States had hoped for due to Switzerland’s restrictive double incrimination principle and a lack of administrative assistance.

The 2003 Tax Information Exchange Act (2003 Act) sought to supplement the 1996 Agreement by proving that "the states will exchange information necessary to properly implement the provisions of the convention or to prevent tax fraud or the like in relation to the taxes that are the subject of the convention." The 2003 Act sought to ensure better information exchange between the two states to ensure that funds associated with illicit activities, such as tax evasion were not protected in safe havens. "The use of the phrase ‘tax fraud or the like’ [within the 2003 Act] was a significant step forward as it signal[ed] that the Swiss [were] willing to work around” their strict fraud tax statues and definitions that have shielded money in Swiss accounts for decades. Both states agreed that fraud was an exception to the

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288 Lovejoy, supra note 272, at 452 (quoting Protocol Amending the Convention Between the Swiss Confederation and the United States of America for the Avoidance of Double Taxation with Respect to Taxes on Income, supra note 287, art. 3, § 5).


290 Brabec, supra note 241, at 254.

291 Id. at 254-55.

292 Id. at 255.


295 Brabec, supra note 241, at 255.
protection of personal and banking privacy.\textsuperscript{296}

Switzerland has also entered into Double Taxation Treaties with seventy-two other states.\textsuperscript{297} These treaties enable states to obtain taxes from their citizens who hold accounts in Swiss banks.\textsuperscript{298} In turn, non-residents are able to obtain a partial or total refund of tax withheld by the Swiss paying agent.\textsuperscript{299}

The Swiss tax policy can be summarized as follows: Switzerland does not levy taxes on Swiss accounts owned by non-residents.\textsuperscript{300} There are three exceptions to this rule. First, “[d]ividends and interest paid by Swiss companies are subject to a 35% withholding tax. The bank will keep 35% of the interest or dividend and send it to the Swiss tax authorities on a no-name basis.”\textsuperscript{301} Foreigners are taxed only if they invest in Swiss companies.\textsuperscript{302} Second, U.S. citizens, green card holders, and U.S. taxpayers must inform the IRS of their Swiss accounts.\textsuperscript{303} Third, in 2001, Switzerland agreed to “extend its 35% withholding tax on resident savings income to non-resident account holders, and to distribute much of the tax collected among EU member states . . . .”\textsuperscript{304} Thus, EU residents “will have to pay a withholding tax on the interest paid by certain investments. This tax starts at 15% and will gradually reach 35%. No exchange of information nor any taxes on capital or capital gains will be levied.”\textsuperscript{305} Both Germany and Great Britain have started to reap the benefits of this agreement.\textsuperscript{306}

\textsuperscript{298} See id.
\textsuperscript{299} Id.
\textsuperscript{300} See id.
\textsuperscript{301} Id.
\textsuperscript{302} See id.
\textsuperscript{303} See id.
\textsuperscript{304} Id.
\textsuperscript{306} See Trouble Island, supra note 87, at 68.
iii. International Pressure for Cooperation after 9/11

The events of 9/11 had a serious impact on both the economic and political landscape of the international system. In the wake of this tragedy, states around the world agreed on the need for greater cooperation and, subsequently, more transparency.\(^{307}\) 9/11 brought into fruition the idea that no state is immune from terrorist attacks in a highly interconnected world.

Prior to 9/11, Switzerland signed a number of multilateral and bilateral international mutual assistance treaties including the following: the European Convention on Mutual Assistance in Criminal Matters (1959); the Treaty on Mutual Assistance in Criminal Matters with the USA (1973); the Federal Act on International Mutual Assistance in Criminal Matters (1983, as amended in 1997); the European Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime (1993).\(^{308}\)

The 1997 amendments to the Federal Act on Mutual Assistance in Criminal Matters “enable[ed] the transmission of documents and information abroad for the purposes of criminal proceedings.”\(^{309}\) However, “the transmission of such information requires the permission of the Swiss police authorities who must inform the customer about the order and give him a right to appeal.”\(^{310}\) Switzerland will only exchange information regarding the individual who is the subject matter of the investigation.\(^{311}\) Moreover, information will not be transmitted if: “the offence alleged is not equally punishable in Switzerland”; “the foreign authorities might use the information for purposes other than those for which it was requested”; “the requesting state does not offer Switzerland reciprocal treatment in these matters”; or “the offence is related to tax, politics or military matters.”\(^{312}\)

According to James Nason, head of international

\(^{307}\) See Brabec, supra note 241, at 239.

\(^{308}\) Switzerland: Double Tax Treaties, supra note 297.

\(^{309}\) Id.

\(^{310}\) See id.

\(^{311}\) Id.

\(^{312}\) Id.
communications at the Swiss Bankers Association,
Swiss judicial sovereignty and the laws that protect it were not written to frustrate legitimate criminal investigations by foreign governments, and Switzerland has been a very reliable partner in the international fight against money laundering, the financing of terrorism and other crimes. After 9/11, Switzerland was one of the first countries fully in a position to help the United States trace and freeze assets linked to terrorist organizations.\textsuperscript{313}

In the wake of 9/11, Switzerland reiterated its commitment to stop individuals and organizations suspected of terrorism from accessing its banking system.\textsuperscript{314} "Even though the Swiss do not have specific anti-terrorism provisions within the Swiss penal code, Swiss law does have provisions relating to murder, hostage-taking, and the use of explosives with criminal intent, all of which are penal norms that implicitly apply to terrorism."\textsuperscript{315} Moreover, the Money Laundering Act "requires all financial intermediaries to freeze the accounts that they reasonably suspect are involved in the commission of criminal activities, including terrorism financing and money laundering."\textsuperscript{316} Once an account is frozen, it must be reported to the Money Laundering Reporting Office of Switzerland.\textsuperscript{317} In 2003, Switzerland amended the penal code to allow banks to freeze assets and punish those who intend to finance a future crime.\textsuperscript{318} Due to these changes, Switzerland froze eighty-two bank accounts (nearly $25.5 million of assets) linked to Al Qaeda, the Taliban and Osama bin Laden.\textsuperscript{319}

The recent amendment to Swiss law could have been partially influenced by the Uniting and Strengthening America by
Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (Patriot Act).\textsuperscript{320} In an attempt to defeat bank secrecy, U.S. banks are prohibited from wiring money to what U.S. authorities classify as shell banks.\textsuperscript{321} US banks must also ask their new clients if they are US citizens, and if they are not, new clients must state their occupation and whether they will be wiring money abroad.\textsuperscript{322} Title III of the Patriot Act (the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001) creates heightened identification requirements for opening bank accounts.\textsuperscript{323} Furthermore, all


\textsuperscript{321} Shell banks are not per se illegal; however, their activities support underground economy and are usually based in tax havens.

\textsuperscript{322} See Lori Richards, Director, Office of Compliance Inspections and Examinations, U.S. Securities & Exchange Commission, Money Laundering: Life After the Patriot Act (May 2, 2002), available at http://www.sec.gov/news/speech/spch555.htm#P115_18198; see also John J. Byrne, Banks and the USA PATRIOT Act, ECON. PERSPECTIVES (Sept. 2004), http://www.hsdl.org/?view&did=455637. John J. Byrne serves as the director of the American Bankers Association’s (the “ABA”) Center for Regulatory Compliance. Id.


(1) IDENTIFICATION AND VERIFICATION OF ACCOUNTHOLDERS—
(1) IN GENERAL—Subject to the requirements of this subsection, the Secretary of the Treasury shall prescribe regulations setting forth the minimum standards for financial institutions and their customers regarding the identity of the customer that shall apply in connection with the opening of an account at a financial institution.

(2) MINIMUM REQUIREMENTS—The regulations shall, at a minimum, require financial institutions to implement, and customers (after being given adequate notice) to comply with, reasonable procedures for—(A) verifying the identity of any person seeking to open an account to the extent reasonable and practicable; (B) maintaining records of the information used to verify a person’s identity, including name, address, and other identifying information; and (C) consulting lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency to determine whether a person seeking to open an account appears on any such list.

(3) FACTORS TO BE CONSIDERED—In prescribing regulations under this subsection, the Secretary shall take into consideration the various types of accounts maintained by various types of financial institutions, the various methods of opening accounts, and the various types of identifying information available.

\textit{Id.}
financial institutions must implement anti-money laundering compliance programs.\textsuperscript{324}

One aspect of the Patriot Act that is in sharp contrast with Swiss privacy laws is Section 314. Specifically, this section requires financial institutions to check account holders’ names for potential matches with names on government watch lists.\textsuperscript{325} United States Treasury’s Financial Crimes Enforcement Network sends requests pursuant to § 314(a), and financial institutions have two weeks to complete their review and respond with any matches.\textsuperscript{326} In the post 9/11 era, financial institutions operating in the United States are required to report suspicious financial activity “in real time” and verify the identity of account holders.\textsuperscript{327} All financial institutions operating in the United States are required to exercise due diligence.\textsuperscript{328} They are reviewed by federal banking agencies and criticized if they fail to exercise due diligence in reviewing high-risk relationships.\textsuperscript{329}

In its 2004 review of the Patriot Act, the 9/11 Commission found that the Act was a positive development but that it needed to intensify efforts to expand and improve communication between actors.\textsuperscript{330} Specifically, the commission stated that “[v]igorous efforts to track terrorist financing must remain front and center in the US counterterrorism efforts.”\textsuperscript{331} They cited “multilateral diplomacy, intelligence cooperation, and concerted international action, such as through the [Financial Action Task Force], FATF, as key components to successfully combating terrorist financing activities.”\textsuperscript{332} Through the Patriot Act, the United States was able

\textsuperscript{324} See id. § 352, 322.
\textsuperscript{325} See id. § 314, 307-08.
\textsuperscript{326} See id. § 310, 329-32; see also Byrne, supra note 321, at 20.
\textsuperscript{327} Byrne, supra note 321, at 19.
\textsuperscript{328} Id.
\textsuperscript{330} See Byrne, supra note 321, at 21.
\textsuperscript{332} Brabec, supra note 241, at 249.
to curtail bank privacy domestically and heavily impact policies of foreign banks operating on its soil.333 In the name of public safety, the Patriot Act aggressively targeted bank secrecy and the Act affected not only Switzerland but all other states that guard the privacy of foreign capital.334

Following 9/11, the international community was also mobilized in targeting terrorist financing. Specifically, FATF established the “Forty Recommendations” targeting money laundering, and terrorist financing.335 In 2001, FATF added Eight Special Recommendations on Terrorist Financing, creating a framework to combat money laundering and terrorist financing.336 The United Nations Security Council (UNSC) passed the 1373 resolution requiring all member states to freeze any assets linked to terrorist organizations.337 The UNSC Resolution 1390 specifically required all members States to freeze the assets of Osama bin Laden, Al Qaeda, and their agents.338 Additionally, “[t]he UNSC formed a Sanctions Committee in Resolution 1267 with regards to Afghanistan. The duties of the Sanctions Committee include the maintenance and updating of lists of individuals and entities subject to sanctions under these resolutions, which all States are obligated to apply.”339 Although Switzerland joined the UN on September 10, 2002 without signing

333 See id. ("Aside from domestic law changes, both the United States and Switzerland adhere to various international agreements.").

334 See id. at 247-48.


336 Id. at 860.


these resolutions, it has since agreed to be bound by them.  

2. Impact from the International Norms of Ethics

Switzerland’s bank secrecy has enabled notorious human rights violators such as Adolf Hitler, Ferdinand Marcos, Nicolai Ceausescu, Mobutu Sese Seku, Jean Claude “Baby Doc” Duvalier, and Kim Jong Il to hide their ill-gotten capital. “International public opinion displays discomfort with the thought of Swiss banks depositing and profiting from funds that are placed there by such notorious individuals.” While testifying for the U.S. Congress in 1996, the Chairman of the World Jewish Congress (WJC) Edgar Bronfman declared that “[n]obody should be allowed to make a profit from the ashes of the Holocaust.”

Others share his sentiments, as there is an increasing awareness of bank secrecy and the role it plays in enabling criminals and human rights violators to prosper. “[C]rime money of all sorts finds its way into Switzerland. Swiss banks receive money generated through political crime, war crime, individual crime (e.g., tax violations, insider trading, illegal laundering, and undisclosed corporate payments) and organized crime . . .” There is a

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341 See Anita Ramasastry, Secrets and Lies? Swiss Banks and International Human Rights, 31 VAND. J. TRANSNAT’L L. 325, 329-30 (1998). In the early 1980s, an ex-Mobutu Minister revealed a list of Mobutu’s estimated holdings including $143 million in a Swiss bank. See Jonathan Kwitny, Out of Zaire: Where Mobutu’s Millions Go, NATION, May 19, 1984, at 593; see also Edward Cody, Swiss Show More Readiness to Freeze Assets of Despots; Ceausescu and Noriega are Latest Targets, WASH. POST, Jan. 31, 1990, at A1 (showing Marcos, Ceausescu, and Duvalier as leaders possibly using Swiss bank accounts).
342 Ramasastry, supra note 341, at 329-30; see Edward Cody, Swiss Show More Readiness to Freeze Assets of Despots: Ceausescu and Noriega are Latest Targets, WASH. POST, Jan. 31, 1990, at A1 (referring to this attitude as “an image problem” according to Swiss officials).
344 See supra text accompanying note 330-333.
problem with this normative approach to business, that is, should Swiss banks make a moral judgment regarding their client before they open an account? Should the international community impose policing tasks on Swiss banks? Robert Studer, president of Union Bank of Switzerland, stated that the bank did not “refuse the money of political leaders as a matter of principle. That would be extraordinarily unjust. But before we do business with a political leader, it first must be approved by a member of the executive board.”

Various laws in Switzerland require banks to ascertain the identity of their customers and refuse them if there is suspicion of illegal activity. Starting in 1977, the Swiss Bankers Association began to take its own measures to prevent illicit use of their banks by adopting a “Convention of Diligence” also known as a “Know Your Customer” Agreement. The Convention of Diligence establishes the following: Swiss banks may not help foreigners to “speculate against the Swiss franc” or violate foreign exchange control regulations; banks are obligated to exercise “due diligence” in ascertaining the true beneficiary of an account; banks must request proof of the identity of the beneficial owner; and bank chiefs must review the applications of foreign statesmen and “turn them down at the first sign of trouble.”

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346 Ramasastry, supra note 341, at 344.
347 Id. at 342 (quoting Rone Tempest, Ex-Despots Can’t Bank on the Swiss: The World’s Dictators are Being Put on Notice-If You’re Ousted, Don’t Expect Your Nest Egg to be Waiting in Zurich or Basel, L.A. TIMES, Jan. 31, 1990, at A1).
349 Hoets & Zwart, supra note 345, at 79.
350 Id.
351 See David Lawday, Psst-Swiss Accounts are no Secret, U.S. NEWS & WORLD REP., July 4, 1988, at 47. (“Absconing with national funds is a crime under Swiss law,”
In 1990, Switzerland added Article 305 to its Penal Code, and under this provision, "[a]ny person who professionally accepts, keeps on deposit, manages, or transfers assets belonging to a third party, and fails to establish with all due diligence the identity of the beneficial owner, shall be punished by imprisonment up to one year, detention, or fine." Thus, bankers have a "duty" to ascertain the customer's identity. In 1992, Switzerland passed another law that prohibited banks from opening anonymous accounts, requiring bank management to check and keep that information confidential.

Switzerland has a mixed record in cooperating in political cases. For example, when Ethiopia's Haile Selassie was dethroned in 1974, Switzerland did not open his account to the new Ethiopian government. Similarly, Switzerland "declined a request by the [new] Iranian government to freeze the funds of the [former] Shah" of Iran. One of the most infamous incidents of Swiss secret banking industry involves the Nazis and Holocaust survivors. True to its neutrality claim, Swiss banks accepted deposits both from the Nazis and the Jewish community. In May 1997, the United States released the Eizenstat Report, which suggested that Swiss banks had enabled the Nazis to "prolong [their] war effort" by moving their "gold and other [financial]...
assets" out of Germany. The heirs of Holocaust victims are still searching for dormant accounts and property that was confiscated from the Jews by the Nazis, and is allegedly hidden in Swiss banks.

According to the Eizenstat Report,

Switzerland's "business as usual" attitude persisted in the postwar negotiations... [T]he Swiss team were obdurate negotiators, using legalistic positions to defend their every interest, regardless of the moral issues also at stake. Initially, for instance, they opposed returning any Nazi gold to those from whom it was stolen, and they denied having received any looted gold.

Furthermore, immediately after WWII, surviving family members had a difficult time accessing the accounts because the Swiss Bankers Association had established rules to identify accounts that made it very difficult for the surviving family members to file a claim. Swiss banks would require heirs of Holocaust victims to provide a death certificate, identify the location of the assets, and demonstrate the right to inheritance.

Perhaps one of the most self-serving agreements that Switzerland entered in relation to Holocaust victims is the June 25,

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359 See Ramasastry, supra note 341, at 350-52 (describing the lawsuits brought against Swiss banks in 1997 and subsequent efforts in to recover and return assets of Nazi victims stored in Swiss banks).

360 Eizenstat Report, supra note 358, at vii.

361 See id. at viii ("Over the years, the inflexibility of the Swiss Bankers' Association and other Swiss banks made it extremely difficult for surviving family members of Nazi victims to successfully file claims to secure bank records and other assets.").

362 See Committee Hearing, supra note 343, at 357-60 (report of Peter Hug & Mark Perrenoud, Assets in Switzerland of Victims of Nazism and the Compensation Agreements with East Bloc Countries, Jan. 17, 1997) (describing two cases in which claimants possessing death certificates and inheritance documents, respectively, struggled to reclaim assets seized by Nazis during WWII).
1949 Swiss-Polish agreement. This agreement allowed Poland to acquire assets of Polish citizens without heirs; the assets would in turn be used to compensate Swiss citizens who had expropriation claims against Poland. Through this agreement Switzerland was able to receive 480,000 Swiss francs. The Jewish community expressed disappointment at the willingness of the Swiss to locate dormant accounts of Polish Holocaust victims but not those of Holocaust victims from other countries.

The Swiss claim that dealing both with Germans and the Allied Forces before and during WWII was a survival strategy to proclaim neutrality and avoid invasion. Switzerland established the Task Force on the Assets of Nazi Victims, charged with investigating the "role and responsibilities of the Swiss authorities before, during, and after WWII." This task force led an investigation into the dormant account matter, and has coordinated its efforts with the Independent Committee of Eminent Persons (ICEP), which conducted a wide-scale audit of Swiss bank records. The scope of ICEP is limited to identifying dormant

363 See EIZENSTAT REPORT, supra note 358, at viii (describing Switzerland’s two agreements with Poland, including an agreement in which “Switzerland agreed to transfer funds in heirless bank accounts from Polish Holocaust survivors and other Polish nationals to the then-Communist government of Poland,” which was coupled with an agreement in which Poland would “satisfy the claims of Swiss businesses for properties expropriated after the War”).

364 Id. at 200.

365 Id.

366 See Ramasastry, supra note 341, at 357 (noting that the Jewish community was “outraged” at the announcement of the Swiss-Polish agreement to return assets of Polish origin held in Switzerland).

367 See Responses to the Eizenstat Report, SWISS REV. WORLD AFF., June 2, 1997, at 28 (noting the Eizenstat Report’s treatment of the Swiss neutrality policy); see also Hugo Butler, Switzerland’s Past Under the Magnifying Glass, SWISS REV. WORLD AFF., Dec. 1, 1997, at 6 (arguing that the intensity of the debate about Switzerland’s role in WWII can be fully comprehended only in light of Switzerland’s neutrality).

368 Committee Hearing, supra note 343, at 32 (statement of the Swiss Ambassador Thomas Borer, Head of the Swiss Task Force on the Assets of Nazi Victims).

369 See id. at 34 (noting Swiss Ambassador Thomas Borer’s assurances that the work of the Swiss Task Force on the Assets of Nazi Victims would “dovetail closely” with the work of the Volker Commission and that the Task Force will keep the Volker Commission up to date about its investigations).
bank accounts of persecuted persons in Swiss banks. On July 23, 1997 the Association of Swiss Bankers publicly identified the names of almost 2000 WWII-era dormant accounts of non-Swiss nationals. On October 29 of the same year, Switzerland published a second list that included “nearly 3,700 foreign-owned and more than 10,000 Swiss-owned dormant accounts.” The publication of these account holders for dormant accounts was a small but significant step toward lessening the iron veil of secrecy in the Swiss banking industry.

Another interesting development in the history of Swiss bank secrecy and international norms of ethics and human rights is the Marcos asset litigation. In 1986, numerous Filipino residents in the United States sued the estate of former Filipino President Ferdinand Marcos, claiming human rights violations under his regime. In 1995, the plaintiffs were awarded $2 billion in judgment and tried to access over $500 million of Marcos’s estate deposited in Swiss accounts. Assets of President Marcos housed in Swiss bank accounts were not accessible to the plaintiffs because Swiss banks had frozen Marcos assets “at the request of the Republic [of Philippines].” In their decisions, both the US district court and the appellate courts recognized the banks as

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370 See Committee Hearing, supra note 343, at 50 (statement of Paul Volcker, Chairman, Independent Committee of Eminent Persons).

371 See David E. Sanger, Swiss Find More Bank Accounts From the War, and Publish List, N.Y. TIMES, July 23, 1997, at A1 (noting that the release of this list of names is a significant break from typically strict Swiss banking privacy laws).


373 See Ralph G. Steinhardt, Fulfilling the Promise of Filartiga: Litigating Human Rights Claims Against the Estate of Ferdinand Marcos, 20 YALE J. INT’L L. 65, 66 n.1 (1995) (detailing the five cases filed against Marcos in the U.S. Circuit Court for the Ninth Circuit, the Multidistrict Litigation consolidation of these cases, and the jury verdict against the Marcos estate in the human rights litigation).

374 See Kristina Luz, Dictators Beware: Torture Victims May Finally See Money from the Marcos Vaults, ASIAWEEK, Oct. 13, 1995, at 48 (noting that the Hawaii District Court granted plaintiffs access to the Marcos assets held in Credit Suisse and the Swiss Banking Corp.).

375 See In re Estate of Ferdinand Marcos Human Rights Litigation, 94 F.3d 539, 543 (9th Cir. 1996) (providing a brief history of the litigation and movement of assets as a result of decisions at the district court level).
“agents” of the Marcos estate as they had played a role in shielding his wealth.\textsuperscript{376}

These two examples (Switzerland’s handling of the Holocaust dormant accounts and U.S. courts’ recognition that banks are not neutral but at times active agents of human rights offenses) demonstrate that there is a nexus between human rights violations and bank secrecy. In the early 1990s, the Swiss began to be more proactive in freezing accounts of known corrupt leaders and cooperating with the international community in recuperating wealth from dictators.\textsuperscript{377} Switzerland’s proactive efforts to seize ill-gotten assets of Ivorian leader Laurent Gbagbo,\textsuperscript{378} Zine al-Abidine Ben Ali,\textsuperscript{379} Moammar Gadhafi,\textsuperscript{380} and Hosni Mubarak\textsuperscript{381} demonstrate that the norms of the international community are slowly penetrating Switzerland’s tight grip on bank secrecy and, by default, its sovereignty.

3. The Use of Domestic Courts to Implement Change in the International Realm: the UBS Deferred Prosecution Agreement

Although international agreements on taxation and security curbed Switzerland’s self-determination and choice of national laws, the use of courts is perhaps the most dramatic and the more efficient way of imposing checks and balances on the Swiss sovereignty. The US courts have long recognized that “the Swiss

\textsuperscript{376} Ramasastry, supra note 341, at 449.

\textsuperscript{377} See id. at 348-49 (discussing the fact that Swiss banks froze the accounts of Benazir Bhutto and her family after allegations of corruption were made against Bhutto).

\textsuperscript{378} See Haig Simonian, Swiss Freeze Ben Ali and Gbagbo Assets, FIN. TIMES (Jan. 19, 2011), http://www.ft.com/intl/cms/s/0/a0ff7106-23e7-11e0-8bb1-00144feab49a.html (explaining that Swiss banks were ordered to freeze the assets of former Ivory Coast President Laurent Gbagbo).

\textsuperscript{379} See id. (noting that the Swiss banks were ordered to freeze the accounts of former Tunisian president Zine al-Abidine Ben Ali).


\textsuperscript{381} Deborah Ball, Mubarak’s Swiss Assets Frozen, WALL ST. J. (Feb. 11, 2011, 8:24 PM), http://online.wsj.com/article/SB10001424052748704329104576138451664628050.html.
interest in bank secrecy is substantial." Although the US Supreme Court warned that "[w]e cannot have trade and commerce in world markets... exclusively on our terms, governed by our laws, and resolved by our courts," the United States has used the power of its own courts to amend Swiss bank secrecy laws. In another case involving Swiss laws, the Supreme Court wrote: "It is hardly debatable that fear of criminal prosecution constitutes a weighty excuse for nonproduction, and this excuse is not weakened because the laws preventing compliance are those of a foreign sovereign." Thus, while the US courts have recognized the need to respect the sovereignty of other states and their laws, they have also highlighted the fact that sovereignty should not shield misconduct.

Like other industrialized states, the US has long dealt with undeclared offshore banking. Under US law, any US citizen that wishes to have accounts overseas must notify the IRS if the total amount in such accounts exceeds $10,000. Both the US Department of Justice (DOJ) and the IRS have tried for years to hold tax-dodgers accountable. In a 1983 report, General Accounting Office, now called Government Accountability Office,
stated that "[t]he use of tax havens has been of particular concern to the IRS since the mid-1950's."\textsuperscript{387} In 2003, the US Senate began an investigation into UBS's involvement in tax havens, and US taxpayer interaction with UBS.\textsuperscript{388} The DOJ followed up on this investigation by pursuing a criminal investigation.\textsuperscript{389} During the same year, the IRS completed a three-month long Offshore Voluntary Compliance Initiative whereby US taxpayers could voluntarily disclose their offshore payment cards or other offshore financial arrangements and come into compliance.\textsuperscript{390} Many of the accounts that were disclosed under this initiative were set up by UBS, and therefore both the "IRS and DOJ focused on any and all activities of UBS with American taxpayers in which American taxpayers could be evading income tax."\textsuperscript{391}

In April 2008, U.S. authorities arrested Bradley Birkenfeld, an American private banker formerly employed by UBS, for conspiring with Mario Staggl "to defraud the IRS by falsifying IRS forms . . . in order to conceal from the IRS United States income paid into Swiss bank accounts beneficially owned by United States taxpayers."\textsuperscript{392} Birkenfeld pled guilty and cooperated


\textsuperscript{389} See generally Lovejoy, supra note 272, at 439 (describing the lead up to the investigation into UBS in 2004, which led to the eventual arrest and indictment of Bradley Birkenfeld).

\textsuperscript{390} See Early Data Show Strong Response to Offshore Initiative; Applicants Owe Millions, Reveal Scores of Promoters, INTERNAL REVENUE SERV. (May 1, 2003), http://www.irs.gov/uac/Early-Data-Show-Strong-Response-to-Offshore-Initiative;-Applicants-Owe-Millions,-Reveal-Scores-of-Promoters ("Applicants to [the Offshore Voluntary Compliance Initiative] had to provide full details on the person or persons who promoted the offshore arrangements. Eligible taxpayers could avoid criminal prosecution and certain penalties but would still have to pay back taxes, interest and some penalties.").

\textsuperscript{391} Lovejoy, supra note 272, at 439.

\textsuperscript{392} Indictment of Bradley Birkenfeld & Mario Staggl, ¶ 6 (S.D.Fla. 2008) (No. 0:08-cr-60099-WJZ).
with the government. He admitted that he was a director in the private division of UBS between 2001 and 2006, and he traveled to the United States to help wealthy Americans conceal their assets from the IRS. He also provided evidence that he and other managers at UBS assisted US clients in “concealing their assets held offshore” by creating nominee and sham entities. By doing so, the bank earned approximately $200 million a year. On July 1, 2008, based on Birkenfeld’s information, the DOJ obtained an order from the U.District Court for the Southern District of Florida to serve a John Doe summons on UBS. The summons required that UBS provide information regarding US taxpayers who used UBS services to evade US taxes. In a certain way, UBS brought this turn of events upon itself. Birkenfeld admitted that he had smuggled diamonds in toothpaste tubes, deliberately destroyed account records of UBS clients overseas, and helped US citizens to hide ownership of their assets by creating fake offshore trusts using false and misleading documentation.

This long effort to crack down on tax-dodging schemes culminated with the UBS signing a Deferred Prosecution Agreement on February 18, 2009. In compliance with this agreement, the Swiss Financial Markets Supervisory Authority (FINMA) ordered UBS to immediately provide US authorities

394 Id.
395 Id.
396 Id.
398 See John Doe Summons Order, supra note 397 (noting that the IRS may serve the John Doe summons ordering UBS to turn over certain information about its accountholders).
with the identities of and account information for American customers of UBS’s cross-border business.\footnote{See id. (noting that UBS complied with the request for information).} Under the Agreement, the bank would “expeditiously exit the business of providing banking services to United States clients with undeclared accounts.”\footnote{Id.} UBS would disclose the identities of approximately 250 customers of UBS’s cross-border business and pay a fine of $780 million.\footnote{Id.; David Voreacos & Carlyn Kolker, \textit{U.S. Sues UBS Seeking Swiss Account Customer Names (Update4)}, BLOOMBERG (Feb. 19, 2009), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=axZmpp36bOA.} On February 19, 2009, the DOJ filed a civil lawsuit against UBS to enforce an IRS summons from July 1, 2008, which would force the bank to disclose the names of “as many as 52,000” US clients.\footnote{\textit{U.S. Steps up Pressure on UBS in Bank Secrets Case}, WASH. EXAMINER (Feb. 18, 2009), http://washingtonexaminer.com/article/103971#.UHsYhY41GFc.} However, according to the Deferred Prosecution Agreement, UBS was permitted to challenge the July 1, 2008, IRS summons.\footnote{See Deferred Prosecution Agreement, \textit{supra} note 231, ¶ 13 (“The United States . . . shall not deem UBS’s . . . exhausting of all available appellate remedies relative to the enforcement of this summons to be a violation or breach of any provision of this Agreement.”).}

Given this legal showdown, UBS and the United States reached an agreement whereby UBS would provide information for about 4,450 account holders.\footnote{See Sven Egenter, \textit{UBS not to pay fine in U.S. tax settlement: reports}, REUTERS (Aug. 2, 2009), http://www.reuters.com/article/2009/08/02/us-ubs-idUSTRE5710I320090802 (noting that negotiations over a final agreement between UBS and the US government are ongoing); see also Ryan J. Donmoyer, \textit{UBS Customers May Have ‘Mere Hours’ to Report to IRS}, BLOOMBERG (June 17, 2010), http://www.bloomberg.com/news/2010-06-17/americans-may-have-mere-hours-to-report-ubs-accounts-to-irs-after-accord.html (noting that UBS had to disclose the names of 4450 clients following an agreement between the US government and the bank).} The agreement had to be approved by the Swiss lawmakers because such disclosure was against Switzerland’s long tradition of bank secrecy.\footnote{See Donmoyer, \textit{supra} note 406 (noting that the Swiss parliament had to approve the UBS deal with the U.S. before the names of any customers of Swiss banks were disclosed to the U.S.).} In March 2009, UBS paid the United States $788 million in fines and handed over the details of 250 accounts of its customers to US
investigators.\textsuperscript{408} Although the United States had threatened criminal prosecution against the bank itself, in the end the case was solved through agreements with both the bank and the Swiss government.\textsuperscript{409}

Arguably, the legal debate between the US authorities and Swiss banks built up for some time prior to the lawsuit.\textsuperscript{410} In the early 1990s Switzerland had to comply with international money laundering laws that exposed notorious dictators and criminals.\textsuperscript{411} Now, however, the agreement between the United States and Switzerland reaches beyond standard tax haven arrangements. In the past, Switzerland only shared client information with international law enforcement agencies if they were investigating a criminal act under Swiss law.\textsuperscript{412} Under the new US-Swiss agreement, which followed the UBS settlement, Switzerland has not changed its laws, but has agreed to reinterpret existing legislation on “tax fraud and the like.”\textsuperscript{413} The Swiss have re-


\textsuperscript{410} See \textit{supra} notes 271-306 and accompanying text (documenting United States efforts via agreements since the 1950s to achieve “information exchange” with Switzerland and the frustration of some of these efforts).

\textsuperscript{411} See Alan Riding, \textit{New Rule Reduces Swiss Banking Secrecy}, N.Y. TIMES, May 6, 1991, at DI (discussing the abolishment of Form B which allowed certain Swiss bank account holders to hide their identities).

\textsuperscript{412} \textsc{Bundesgesetz hber internationale rechtshilfe in Strafsachen [General Federal Act on International Assistance in Criminal Matters]} [hereinafter IMAC], 1981 SR 351.1; \textsc{loi fédérale sur l’entraide internationale en matière pénale [LB] [Federal Act on International Mutual Assistance in Criminal Matters]}, Mar. 20, 1981, \textsc{recueil systématique du droit fédéral [RS]} 351.1, art. 6 (Switz.).

\textsuperscript{413} See Eric M. Victorson, United States v. UBS AG: Has the United States Successfully Cracked the Vault to Swiss Banking Secrecy, 19 Cardozo J. Int’l & Comp. L. 815, 833-34, 838 (2011) (noting that the parties to the agreement “agreed to clarify and liberalize the standards upon which information can be shared to combat tax crimes.”).
assessed what is "tax evasion," which would allow UBS to give account information to the Swiss Financial Tax Administration, who will then release it to the IRS. By giving the Swiss authorities the first chance to review these accounts, the new agreement does not technically break Swiss laws on banking. The September 2009 agreement is based on the 1996 bilateral agreement on tax evasion. This most recent amendment to the treaty will have profound consequences not just for UBS but also for all other Swiss banks that serve US customers. By using the power of its domestic legal system, the United States was able make Swiss banking polices more transparent for IRS review.

VI. Changes in Swiss Banking Laws: the Result of Pressures within or from the Outside? Is There a Form of Checks and Balances in the International System of States?

The changes in Swiss banking laws are the result of a combination of domestic and international forces. Perhaps the interaction between the international community, Switzerland, and UBS is better explained through the lenses of post-rationalist global political economy. While classical political economy is based on a "rationalist epistemology" where states and firms are "assumed to be rational, calculating 'actors,' with clear—usually utility maximizing—preferences," post-rationalist global economy maintains that the world is not governed by "iron laws" and universally accepted norms. Post-rationalist political economy

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414 See id. at 834 ("[T]he Double Taxation Amendment broadens the types of cases eligible for information sharing assistance from the competent governmental authorities to include cases of tax fraud and tax evasion.").

415 See id. ("Because treaties supersede domestic statutes in Switzerland, the provisions in the Double Taxation Amendment calling for information sharing trump Swiss banking secrecy laws.").

416 See id. at 830, 833 (discussing the original 1996 Double Taxation Treaty and the update to that treaty in 2009 following the U.S. government's settlement with UBS).

417 See generally RONEN PALAN ET AL., GLOBAL POLITICAL ECONOMY: CONTEMPORARY THEORIES 15 (Ronen Palan ed., 2000) [hereinafter PALAN ET AL., GLOBAL POLITICAL ECONOMY] ("Post-rationalism consists of sets of theories that explain order—and disorder—as the product of institutional and historical continuity, formal and informal rules of conduct, social and institutional interaction, common pathologies, consciousness and language, conflict and contest, and so on.").

418 Id.
"adopts an open-ended historical narrative in which outcomes are not predictable, but negotiated and consented, with each actor-network perpetually frightened of loss or stasis." \(^{419}\)

In the case of Switzerland, both the relationship between the state and the banks, and the relationship of the state with the international community is better understood as an evolutionary process, viewed through a historical analysis. \(^{420}\) A strictly utilitarian, profit and power maximizing model does not explain the nuances of state behavior in the contemporary international system of states. \(^{421}\) The changes in Swiss banking laws were not the result of an amalgamation of forces between the United States and the European financial hegemony against the Swiss state. \(^{422}\) Neither was Switzerland eager to modify its laws to conform to international standards. \(^{423}\) Rather this was a political, historical, and judicial process with multiple actors often acting with limited information and, at times, against their long-term interest. \(^{424}\) Through a historical review of both domestic and international laws, significant events, and socio-economic trends, this article answers the first question, the source of the changes, by showing that state behavior is evolutionary and dynamic. In other words, states learn to adapt to changes in the international system.

\(^{419}\) Id. This theory is based on Foucault’s “concept of agency.” See id. Foucault argues that “historical change” is in part the product of “collective agencies,” whose identity “emerge[s] in discourse” and “that cannot be defined as institutions or as social classes.” Id. at 15 (citing MICHEL FOUCAULT, DISCIPLINE AND PUNISH: THE BIRTH OF THE PRISON, (Alan Sheridan trans., Vintage Books 1977 (1975))).

\(^{420}\) Id. (“[P]ost-rationalist [global political economy] adopts an open-ended historical narrative.”).

\(^{421}\) See generally PALAN ET AL., GLOBAL POLITICAL ECONOMY, supra note 417, at 15. ("States and multinational enterprises are viewed no longer simply as instrumentalist advantage-maximizing institutions, but as complex organizations which exceed their goals and functions but in non-utilitarian ways.").

\(^{422}\) Cf. Victorson, supra note 413, at 444 (noting Switzerland’s desire to improve its “tarnished image” primarily motivating the country to enter into agreements that would ultimately scale back Swiss banking secrecy protections).

\(^{423}\) See Crovitz, supra note 228 (noting that the Swiss resisted changing their banking secrecy laws to accommodate international pressure).

\(^{424}\) For earlier discussion about the political, judicial, and historical processes that contributed to Switzerland’s decision to modify its banking secrecy laws, see, for example, supra text accompanying notes 257-258, 308, 412.
This article addresses the second question, that of the existence of checks and balances, in its discussion of how the international community brought about the changes in Swiss secrecy laws. The term “checks and balances,” as used here, serves to describe control of the international system of states over individual state’s sovereignty. The use of this term needs to be distinguished from the classical definition of checks and balances in the context of separation of powers. That is, this term is not used to describe separation of the judiciary, legislative, and administrative branches of government and their system of checks and balances on each other, but rather, this article borrows this phrase to describe tools that the international system used to modify Switzerland’s claim on absolute sovereignty.

The international community used the power of treaties (legislative means), international organizations (administrative means), and courts (judicial means) to modify Switzerland’s behavior. In other words the three elements of the classical definition of the checks and balances are not creating an equilibrium between each other, but they are used in concert to create an equilibrium in the international system of states.

The process of modifying state behavior as described in this article differs and is not necessarily the product of balance of powers in the international system of states. The changes in banking law secrecy were not strictly the result of equilibrium between competing forces but rather an elaborate fusion of elements from international law, domestic law and courts, and regulatory bodies. International agreements (such as the European Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime, 1993), international organizations (such as OECD), and courts (for example, the US District Court for the

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425 See, e.g., The Federalist No. 51 (James Madison) (explaining the reasoning behind this concept).

426 See supra note 10 and accompanying text (discussing the use of the term).

427 For discussion about the specific legislative, administrative, and judicial means used by the international community to prompt a change in Swiss banking secrecy practices, see, for example, supra text accompanying note 402.

428 For earlier discussion about the dynamics of the balance of powers in the international system of states, see, for example, supra text accompanying note 402.
Southern District of Florida) acted in concert as tools for the international system of states to rein in one state’s use of sovereignty to protect illegal activity.\footnote{For additional discussion about the role of international organizations, courts, and agreements as tools in the international system of states, see, for example, supra text accompanying notes 258, 308, and 398.}

Driven by pragmatic needs to exercise sovereign powers over their own citizens and also employing normative considerations, industrialized states successfully used three distinct elements of governance to bring change in the international realm. Thus, the international system of states uses the classic elements of checks and balances to modify well-established notions of national self-determination and sovereignty. The case of Switzerland shows that the need for tax revenue, security, and increased standards of normative behavior in the international system persuades states to curb their claim to absolute sovereignty. On the other hand, the states themselves pursue their interests by reacting to the international community and conforming to the world around them.

**VII. Conclusion**

Although Switzerland was able to carefully navigate a difficult situation between one of its major banks and US demands for transparency,\footnote{See, e.g., *UBS case*, *Switz. Fed. Dep’t of Just. & Police*, http://www.ejpd.admin.ch/content/ejpd/en/home/themen/wirtschaft/ref_fallubs.html (last modified July 15, 2010) (providing a detailed timeline of Switzerland’s activity in the UBS litigation since 2009).} this is by no means the end of Swiss power to protect foreign capital from their home countries. Tax havens cannot be agreed away as they are the byproduct of national sovereignty in the age of globalization.\footnote{See Palan, *Tax Havens*, supra note 60, at 173 (“Tax havens cannot simply be legislated away, because they are not perversions of the principle of sovereignty as much as they are a direct outcome of the conflicting principles of national sovereignty in the age of mobile capital.”).} Pressure on tax havens to conform to international agreements on transparency seems to have a balloon effect, in that pressure and changes on one state pushes businesses to seek favorable taxes and regulations
Indeed, Switzerland will continue to be one of the more appealing states in which to invest because it has historically been one of the most stable economies in the world. In its constitution, Switzerland acknowledges that one of the goals of the Swiss banks is to create a healthy economic environment. Not surprisingly, the Swiss financial sector currently accounts for almost eleven percent of its GDP. Although the bank secrecy laws established after WWI have significantly contributed to Switzerland’s stable economy, Switzerland has acknowledged that the March 2009 agreement does not mean that there will be arbitrary exchange of information. Moreover, their tax system is highly attractive to foreign investors. The tax difference between the United States and Switzerland is so significant that two major tobacco companies, RJ Reynolds and Philip Morris, moved their headquarters to Switzerland to take advantage of the country’s tax laws. In light of market fears both in the United

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432 See Palan, Offshore World, supra note 106, at 136-38 ("Fierce competition has led simultaneously to the proliferation of tax havens, whereby jurisdictions actively compete and emulate each other’s laws.")


434 See Constitution Fédérale (CST) [Constituition], Apr. 18, 1999, RO 101, art. 94, para. 3, available at http://www.admin.ch/ch/e/rs/101/index.html (translated by The Federal Authorities of the Swiss Confederation) ("The Confederation and the Cantons shall abide by the principle of economic freedom. They shall safeguard the interests of the Swiss economy as a whole and, together with the private sector, shall contribute to the welfare and economic security of the population.").

435 Swiss Confederation Fed. Dep’t of Fin., Switzerland as a Location for Financial Services: Figures 2 (Swiss Confederation Fed. Dep’t of Fin. 2011); see also Brabec, supra note 241, at 251 (noting that "[a] staggering one-third of all cross-border private banking is managed by the Swiss financial sector").

436 See Bondi, supra note 215, at 12 ("UBS Chairman Villiger cautioned, however, that he did not expect the agreement would lead to automatic exchanges of client data between countries in the future.").


438 See Mark Shapiro & Frank Schröder, Money Laundering and Tax Havens: The Hidden Billions for Development Conference Report, Dialogue on
States and in the EU, the Swiss Franc rose over two and a half percent against the Euro in 2011. Indeed, the Swiss Franc has seen a sharp rise against the Euro in the past four years including a nineteen percent jump in 2010. In 2011, the Swiss currency became so strong that the Swiss National Bank had to intervene to weaken the franc. In a statement the Swiss National Bank said:

The current massive overvaluation of the Swiss franc poses an acute threat to the Swiss economy and carries the risk of a deflationary development. The Swiss National Bank is therefore aiming for a substantial and sustained weakening of the Swiss franc. With immediate effect, it will no longer tolerate an EUR/CHF exchange rate below the minimum rate of CHF 1.20. The SNB will enforce this minimum rate with the utmost determination and is prepared to buy foreign currency in unlimited quantities.

These events show that Switzerland has the financial strength and infrastructure to overcome any temporary setbacks created by the modification of its bank secrecy laws. Indeed, the Swiss are committed to maintaining a prosperous economy and political independence. It is the Swiss banks’ world-renowned reputation of stability, confidentiality, and predictability that has been a source of success and Switzerland has a great interest in keeping that reputation intact. In the era of interdependence and globalization, the Swiss also have an interest in distancing...
themselves from any association with criminals, terrorists, and dictators. Their "risk-averse" banking system and "fiscally conservative" policies yield enormous investments and profits, thus Swiss banks do not have the need to be involved with money laundering activities or create tax havens in order to prosper.

Even though complying with U.S. demands and exposing the names of 4450 clients shook market confidence and caused UBS to lose $17 billion in 2008, this is a short-term loss and a long-term benefit. By entering into international agreements and modifying its internal policies, Switzerland has been able to continue doing successful business with the international community without the constant legal friction over tax evasion and criminal activity.

As a last remark, it is important to note that any serious attempt to eradicate tax havens would have to involve all major international actors, with dire consequences for the doctrine of state sovereignty. The abolition of tax havens would involve the cooperation of all industrialized nations and, if successful, it would effectively end the Westphalian system of states. While the prospect of more transparency and proper taxation is appealing, severely diminishing state sovereignty and curtailing the Westphalian system of states would have unintended and perhaps unwanted consequences.

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445 See generally id. (discussing the relationship of crimes to "bank secrecy").

446 Helena Bachman, The Swiss Question Their Once Proud Banks, TIME, ¶ 3 (Mar. 5, 2009), http://www.time.com/time/business/article/0,8599,1883255,00.html (characterizing the Swiss as "fiscally conservative" and "risk-averse"); see also Brabec, supra note 241, at 246 (describing the measures taken by Swiss banks to limit the use of their banks by those individuals alleged to be involved in illegal activity).

447 See Nelson D. Schwartz, For Swiss Banks, an Uncomfortable Spotlight, N.Y. TIMES, Mar. 4, 2009, at B1 (noting the confidence of the chief executive of the Swiss Bankers Association that Switzerland will continue to "retain its position as a global wealth haven" despite having to turn over certain records to the United States).